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BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D. C.

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OST-95-792-1

Joint Application of

AMERICAN AIRLINES, INC. and
EXECUTIVE AIRLINES, INC., FLAGSHIP
AIRLINES, INC., SIMMONS AIRLINES,
INC., and WINGS WEST AIRLINES, INC.
(d/b/a AMERICAN EAGLE)
and
CANADIAN AIRLINES INTERNATIONAL LTD.
and ONTARIO EXPRESS LTD. and TIME AIR
INC. (d/b/a CANADIAN REGIONAL) and
INTER-CANADIAN (1991) INC.

OST-95- 792

under 49 USC 41308 and 41309 for approval
of and antitrust immunity for commercial
alliance agreement

JOINT APPLICATION OF AMERICAN AIRLINES, INC. et al.
AND CANADIAN AIRLINES INTERNATIONAL LTD. et al. FOR APPROVAL
OF AND ANTITRUST IMMUNITY FOR COMMERCIAL ALLIANCE AGREEMENT

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I. INTRODUCTION AND BACKGROUND

American Airlines, Inc. and its regional affiliates
Executive Airlines, Inc., Flagship Airlines, Inc., Simmons
Airlines, Inc., and Wings West Airlines, Inc. (d/b/a American
Eagle) and Canadian Airlines International Ltd. and its region-
al affiliates Ontario Express Ltd. and **Time Air** Inc. (d/b/a
Canadian Regional) and Inter-Canadian (1991) Inc. hereby apply,
under 49 USC 41308 and 41309, for approval of and antitrust
immunity for the attached Commercial Alliance Agreement (Exhib-
it JA-1).

The Commercial Alliance Agreement creates a legal framework which, subject to negotiation and execution of a definitive operating agreement consistent with this framework, will allow American and its regional affiliates and Canadian and its regional affiliates, while retaining their separate corporate and national identities, jointly to cooperate to the extent necessary to create a seamless air transport system. The resulting global alliance will be pro-competitive and **pro-consumer**, and will bring to the marketplace significant service and pricing benefits through the substantial expansion of on-line services that will be made possible by linking the networks of the respective applicants.

The Joint Applicants seek to establish the same kind of multi-hub network that American and other U.S. carriers have successfully created in the domestic U.S. marketplace, and that has proven to be beneficial to U.S. consumers. The proposed network will be similar to the network already created by **KLM** and Northwest and that has been immunized by the Department, and the one proposed by Delta and Swissair, Sabena, and Austrian Airlines as to which approval and antitrust immunity are pending in Docket OST-95-618. Antitrust immunity is necessary to achieve the full benefits of the proposed **American/Canadian** network because, as a practical matter, the carriers will not

implement their Commercial Alliance Agreement without such immunity.

The Commercial Alliance Agreement is fully consistent with, and a natural development foreseen in, the recently issued United States International Air Transportation Policy:

"To meet demand and to improve their efficiency, many carriers are developing international **hub-and-spoke** systems that permit them to combine traffic flows from many routes (the 'spokes') at a central point (the '**hub**') and transport them to another point either directly or through a hub in another region. Just as U.S. carriers developed hub-and-spoke systems to tap the broad traffic pool in the domestic market and to provide the most cost-efficient service for hundreds of communities that could not support direct service, international air carriers are developing world-wide hub-and-spoke systems to tap the substantial pool of international **city-pairs**. Internationally, an even larger portion of traffic moving over hub-and-spoke systems will require the use of at least two hubs (e.g., a hub in both the U.S. and Europe for a passenger moving from an interior U.S. point to a point beyond the European hub). This increases the complexity and interdependence of the components of the systems (both the spokes and hubs) and the importance of multinational traffic rights to the success of the **system**" (60 Fed. Reg. 21841, 21842, May 3, 1995).

As Secretary **Pena** observed when he issued the final Policy Statement,

"Although [point-to-point] operations continue to be important components of international air transport, major changes have occurred during the past few years that are challenging traditional notions of these services. Airlines are becoming increasingly global. Route networks are now being linked in alliances consisting of carriers from different nations, with **interna-**

tional hub-and-spoke networks that offer passengers on-line service to cities around the **world**" (Statement of Secretary **Pena**, April 25, 1995).

Approval of and immunity for the American/Canadian Commercial Alliance Agreement will produce substantial public benefits. The proposed alliance will create network synergies by (1) linking the U.S. and Canadian hubs of the alliance partners, (2) producing cost efficiencies and savings through integration and coordination which can be passed on to consumers in the form of lower fares and improved service, and (3) increasing competition in the U.S.-Canada and other international markets. As the GAO Report on airline alliances has noted,

"In the long run, consumers could pay lower fares, according to many U.S. and foreign airline representatives, as (1) airlines in alliances integrate further and achieve cost efficiencies that could be passed on to the consumer and (2) competition increases among alliances and between alliances and other airlines" (GAO Report to Congress, International Aviation, April 1995, pp. 44-45).

In order to gain these benefits, the Joint Applicants have decided to form an alliance, because legal and other obstacles preclude the formation of integrated route systems either individually or through a merger. The Joint Applicants have not been able individually to develop and expand an integrated network of U.S.-Canada services on a cost-efficient basis because of bilateral obstacles and the enormous financial

burden required to set up meaningful transborder hubs. In addition, prohibitions against **cabotage** prevent foreign airlines from operating service between the U.S. and Canada. Moreover, U.S. and Canadian laws concerning nationality and ownership effectively preclude mergers of airlines of different nations, although there is little question that such a merger would pass muster under the U.S. antitrust laws. A merger of the applicants would largely be end-to-end and would have little effect on horizontal competition.

The comprehensive commercial cooperation envisioned by the Commercial Alliance Agreement requires the applicants to reach an agreement that will expose them to the risk that their coordinated activities could be challenged on antitrust grounds. Although the arrangement proposed by the carriers would be pro-competitive and produce efficiencies, the applicants are not willing to implement the Commercial Alliance Agreement unless they are shielded from such attacks. As noted in the GAO Report, "**the** key benefit of immunity...is the protection from legal challenge by other airlines," thereby allowing the carriers "**to** more closely integrate their operations and marketing than they otherwise would for fear of legal reprisal" (p. 30).

In the absence of immunity, it is virtually impossible to engage in the close levels of collaboration and **coordi-**

nation that is necessary to integrate the carriers' respective networks into an effective multi-hub U.S.-Canada alliance. Without antitrust immunity, the carriers must confine their cooperative marketing relationship to the current limited **code-sharing** and similar arrangements on certain routes where the carriers essentially share aircraft space but continue to be marketplace rivals. The current code-sharing arrangements between American and Canadian and their regional affiliates represent only a small portion of the carriers' total services.

While the existing code-sharing arrangement has been beneficial both to the Joint Applicants and to their customers, without closer collaboration the carriers are unable to develop the efficiencies and achieve the market expansion benefits that would be available through the proposed Commercial Alliance Agreement. Under the current regime, joint sales on **commonly-served** routes are precluded and, in the absence of the ability to negotiate revenue divisions, the carriers lack the financial incentive to interconnect their networks by coordinating schedules in order to direct connecting traffic to code-sharing flights. As the GAO Report pointed out, "[w]ithout immunity, airlines that are significant competitors cannot discuss pricing issues and must develop prorated agreements in 'arm's length' negotiations to divide revenues, a cumbersome process when thousands of city-pairs are involved" (p. 29).

As the Joint Applicants demonstrate below, approval of the Commercial Alliance Agreement coupled with antitrust immunity would be consistent with the statutory standards since such approval and immunity would not be adverse to the public interest and would enhance competition. Furthermore, the grant of antitrust immunity is required by the public interest since it is necessary to enable the parties to proceed with the proposed pro-competitive transaction.

American, as the U.S. partner to the proposed alliance, submits that the grant of antitrust immunity will advance U.S. international aviation policy objectives. Approval will accelerate liberalization of the international marketplace, thus achieving an important goal of the Department's Open Skies initiative. The U.S. Open Skies initiative is bringing some pressure on other countries for multilateral liberalization. While the Open Skies initiative represents a forward-thinking approach to liberalizing international markets, open skies bilateral agreements with smaller countries will not be sufficient to encourage the larger and restrictive aviation regimes to eschew their protectionist policies. Actual competitive pressure in the marketplace -- such as would be made possible by the alliance proposed here -- will change aeropolitical policy. Approval of the proposed Commercial Alliance Agreement coupled with antitrust immunity will generate economic and

competitive pressures that will create real marketplace incentives that are essential to foster and accelerate meaningful reform. American believes that antitrust immunity is a powerful, strategic negotiating tool to encourage foreign governments to eliminate restrictions on U.S. airlines. See GAO Report, p. 54.

As Secretary **Pena** has stated,

"Some carriers engaged in alliances with foreign airlines have raised the possibility of seeking antitrust immunity from the Department of Transportation, asserting that such immunity is important, if not essential, to maximizing the benefits of integrated alliances. My Department is actively considering this question of antitrust immunity. Where the overall net effect of a particular transaction for which immunity is sought is procompetitive and proconsumer, there may be important benefits to be gained from granting immunity in appropriate cases. The existence of an 'open skies' environment, and the elimination of other competitive restrictions, would be key factors in any consideration of a request for immunity" (Statement of Secretary **Pena** before the Senate Commerce Committee on Commerce, Science, and Transportation, July 11, 1995, pp. 13-14).

This application meets the Secretary's expressed objectives.

In addition, approval of the Commercial Alliance Agreement and the grant of antitrust immunity is warranted by foreign policy considerations and is consistent with the newly liberalized Air Transport Agreement between the United States and Canada. In **KLM/Northwest**, Order 93-1-11, the Department concluded that approval of the **KLM/Northwest** integration

agreement with antitrust immunity was consistent with the spirit of the U.S.-Netherlands Air Transport Agreement. Indeed, even though there was no specific provision in the Netherlands MOU requiring approval, the Department determined that **"the** Netherlands would consider a denial of immunity contrary to the Open Skies initiative, unless we had a strong basis for a refusal to grant antitrust immunity" (Order 93-1-11, p. 12). As the GAO Report stated,

"In approving the **Northwest/KLM** application for antitrust immunity, DOT emphasized that the grant of such immunity was consistent with the open skies accord. DOT also implied a favorable treatment of future applications by other U.S. and foreign airlines in exchange for liberal aviation **accords**" (p. 52).

The liberalized agreement with Canada provides the same compelling basis for grant of immunity as the Netherlands agreement, because the Canada agreement creates a framework for carriers to participate in the globalization of air services. Canada could view a denial of this Joint Application as contrary to the spirit of the new U.S.-Canada agreement.

During the negotiations leading to the U.S.-Canada liberalized accord, Canadian negotiators sought U.S. agreement that requests for immunity would be given favorable consideration. The U.S. negotiators responded that antitrust immunity was unnecessary because there was little antitrust risk from cooperative conduct by airlines of the U.S. and Canada. The

U.S. negotiators cited the Department's decision in KLM/Northwest, Order 93-1-11, which found antitrust risk to arise only from cooperation on city-pairs where both carriers operated aircraft (such as Minneapolis/St. Paul-Amsterdam) and new entry was unlikely. Thus, the final U.S.-Canada Agreement is premised on these explanations. Refusing to grant immunity to a proposed alliance which will also operate in overlapping city-pairs and which offers at least the public benefits brought about by the **KLM/Northwest** venture could be viewed as antithetical to the U.S. position in its negotiations with Canada.

Uniform, fair, and consistent application of regulatory policy requires the Department to accord similar antitrust immunity to the Joint Applicants to avoid a double standard. It would be contrary to public policy for the Department to perpetuate a two-class system under which only one alliance (**KLM/Northwest**) is accorded unique antitrust treatment not available to other alliances involving carriers from countries with liberal agreements. There are no significant commercial, competitive, or aeropolitical distinctions between the instant Commercial Alliance Agreement and the **KLM/Northwest** agreement (or the proposed **Delta/Swissair/Sabena/Austrian** agreements pending in Docket OST-95-618) that would justify denial of antitrust immunity here.

The American/Canadian Commercial Alliance Agreement is pro-competitive. Approval of the Commercial Alliance Agreement and the grant of antitrust immunity is consistent with existing law, policy, and precedent, and is necessary to give full effect to the liberalized U.S.-Canada Air Transport Agreement.

II. THE AMERICAN/CANADIAN COMMERCIAL ALLIANCE AGREEMENT

The Joint Applicants propose to expand their existing cooperative marketing relationship, which has involved **code-**sharing arrangements on a limited number of routes, by entering into a Commercial Alliance Agreement. The purpose of the Commercial Alliance Agreement is to establish a contractual framework for the future comprehensive collaboration and coordination by the carriers in a proposed alliance. If the Commercial Alliance Agreement is approved and antitrust immunity is granted, the applicants will then proceed to negotiate and conclude operating accords that will provide for specific coordination/integration undertakings with respect to scheduling, marketing, pricing, planning, joint services, and related matters. The Joint Applicants have not yet made such agreements because, in the absence of immunity, such arrangements might subject the carriers to the risk of an antitrust lawsuit.

The Commercial Alliance Agreement submitted herewith establishes a general framework for subsequent definitive agreements that will permit coordination in the following key areas.

1. Passenger Program. In order to achieve a comprehensive global marketing and sales program of air transportation on American and Canadian, the parties will proceed to negotiate one or more agreements in the following areas:

a. Service Standards. The creation of mechanisms to promulgate, administer, and enforce the levels of quality and service standards and to ensure that the cooperative service products are viewed **as seamless** and transparent to customers. In this regard, passengers booked and ticketed on the cooperative services of the parties will receive the **same** service and amenities, both on the ground and in-flight, as the parties' own on-line passengers.

b. Operating Committees. The establishment of one or more operational committees to oversee joint project development, budgets, directions, and other cooperative activities.

c. Service Contracts. The use of service contracts between the parties and standard service contracts with third parties to avoid redundancy and to ensure that the delivery of services is consistent with the joint products and joint identifies of the parties.

d. Schedule Coordination. The coordination of schedules, third party marketing, network planning, and information systems to maximize sales possibilities by connecting services between the American and Canadian systems.

e. New Markets. The entry of either carrier into new markets, as regulatory requirements permit, in order to expand the combined presence of American and Canadian throughout transportation markets worldwide.

f. Passenger Pricing and Inventory Strategy. The pricing strategy and the fares to be charged and inventory management, including systems, by each air carrier with respect to all passenger program products, including wholesale net fares, corporate discount programs, and airline prorates.

g. Sales Personnel. A combination of American and Canadian sales personnel, including a common staff, who would be authorized to represent both American and Canadian, independently and jointly, in marketing their products to customers and travel agents for sales of the services offered by both carriers. The joint marketing program may be structured as an alliance of American and Canadian selling a seamless, **on-line-**quality joint product or set of products.

h. Commission Coordination. The establishment of unified commission programs, including agency, group, corporate, and override commissions programs to be agreed upon from time to time by the parties.

i. Travel Agent Contracts. The development and use of standard form contracts for sales to travel agencies, general sales agents, corporations, organizations, and individuals.

j. Advertising and Media Programs. The establishment of advertising and media programs that jointly promote American and Canadian as a seamless, worldwide transportation system, consistent with applicable regulations concerning the advertising of code-share services.

k. Ancillary Programs. The establishment of ancillary programs, including, without limitation, travel packages, coordination of facilities, information systems, or mail service to enhance the product marketed by the parties.

l. Frequent Flyer Program Coordination. The coordination of frequent flyer and similar programs, including elements thereof pertaining to mileage accrual and redemption rates, frequent flyer upgrades, and promotional programs.

m. Revenue Allocation. The establishment of agreements and procedures for the allocation of revenues on specific routes.

n. Partner Incentives. The establishment of incentives to ensure that each carrier is fully committed to the success of the cooperative service products.

o. Marketing and Accounting Information. The joint use of marketing and accounting data, and information systems available to the parties, consistent with and subject to all applicable laws and agreements governing each party.

p. Joint Identity. The development of a joint identity for their code-share product(s) through jointly developed service logos, symbols or names, that would maintain the identity marks of the individual carriers consistent with the requirements of 14 CFR 399.82, and which will describe or identify the services, products, or programs of either or both carriers, whether or not previously registered as trademarks in the United States, Canada, or any other country.

q. Resolution of Disputes. The assignment of specific personnel from both carriers, at various levels, with authority to resolve disputes or waive conditions.

2. Cargo Program. In addition to the passenger program, the cooperative marketing operations of the parties will include joint cargo sales and marketing. The terms of the cargo program will include those elements on which the parties mutually agree including, without limitation, elements equivalent to those in the passenger program and the marketing of

both carriers' air transportation of cargo through cooperative, joint marketing, and operations programs.

3. Fully Integrated Marketing Force. The parties will expand the passenger program and the cargo program so as to ultimately provide a fully integrated marketing force throughout the world to aggressively sell and market the products and services of American and Canadian both independently and jointly. Any expansion of these programs will be subject to mutual written consent of American and Canadian.

4. Prior Consent of the Parties Required. All aspects of commercial cooperation will be subject to the prior review and written approval of both American and Canadian. Each party will at all times retain and exercise its own managerial control and decision-making authority in regard to any decision by it to engage in any aspect of their proposed commercial cooperation.

The foregoing areas of coordination will allow the carriers to generate significant efficiencies and provide a broad array of enhanced on-line services. The Department's study on code-sharing and other cooperative arrangements highlighted the benefits that can be garnered through antitrust immunity:

"The strongest type of airline alliance can be formed when two airlines are granted antitrust immunity. The granting of antitrust exemption permits carriers involved in international alli-

ances to discuss and jointly decide on fare levels and the capacity deployed.... The result is that both airlines can aggressively market service in every city-pair market they serve.

"Antitrust immunity is a powerful business tool in permitting carriers that exist as separate corporate entities to act as one business firm. Absent the legal ability to merge, antitrust immunity may yield many of the benefits of merger while avoiding prohibitions against international ownership.

"Antitrust immunity allows alliance partners to share revenue equally, assuring that both carriers can capture the benefits of the **alliance**" (Study of International Airline Code-Sharing, Prepared for the Office of the Secretary of Transportation, December 9, 1994, p. 9).

III. THE COMMERCIAL ALLIANCE AGREEMENT SHOULD BE APPROVED UNDER 49 USC 41309 AND ANTITRUST IMMUNITY SHOULD BE GRANTED UNDER 49 USC 41308

A. Grant Of The Joint Application Will Provide Important Public Benefits That Will Not Otherwise Be Possible

The Commercial Alliance Agreement will allow American and Canadian to create a multi-hub network of services between the U.S. and Canada, similar to the successful multi-hub networks operated in the domestic U.S. marketplace. The **U.S.-Canada** market is the world's largest and most competitive international air transportation market. The most efficient and competitive way to build a U.S.-Canada system is to establish hubs on both sides of the border to generate and enhance network-to-network traffic flows.

American and other U.S. carriers have demonstrated that, through coordination of multiple hubs, many more cities can be served, with greater frequency, via on-line connections than would be the case with no hub or with only single hub systems. To maximize competition between the U.S. and Canada, carriers must have the ability to flow traffic over **hub-and-spoke** systems in both the United States and Canada. It is economically, politically, and legally impracticable for American and its regional affiliates to develop and build their own Canada-based multi-hub network, and likewise for Canadian and its regional affiliates to develop their own hub networks in the United States.

The Department has recognized the difficulties faced by carriers in developing their own global networks of direct service, noting that there are substantial **"obstacles"** that prevent U.S. carriers from developing their own global systems of direct service. These obstacles include (1) the lack of "substantial access not only to key hub cities overseas, but also through and beyond them to numerous other cities, mostly in third **countries"**; (2) the lack of "access to a large number of gates and takeoff/landing slots, frequently at some of the world's most congested airports"; (3) the lack of **"considerable** financial resources [necessary] to establish and sustain commercially successful overseas hub **systems"**; and (4) **"the**

[in]ability to obtain infrastructure and establish market presence in a new region **quickly**" (DOT Policy Statement, 60 Fed. Reg. 21842).

The proposed American/Canadian alliance meets a specific pro-competitive need to balance the market power held by Air Canada. Air Canada dominates both the market within Canada -- with a 58 percent share of scheduled domestic revenues -- and the transborder market -- with a 25 percent share of transborder frequencies (see Exhibit JA-2). Canadian, based in western Canada, operates only 4.9 percent of the weekly transborder frequencies provided by the airlines of the U.S. and Canada -- one-fifth the number operated by Air Canada, and far fewer than United, Delta, Northwest, or **USAir**. The only way in which Canadian can compete effectively against Air Canada and the strong U.S. carriers serving transborder markets is to take advantage of the combined traffic flows generated by the American/Canadian alliance, and thereby offer on-line competitive service to more passengers. Without immunity, which would permit American and Canadian to cooperate fully and take advantage of their combined synergies, Canadian will remain at a substantial competitive disadvantage against Air Canada and its growing cooperative relationship with United and Continental.

There is no reason why KLM and Northwest should have the unique ability, among all the airlines serving the United States, to operate under an antitrust exemption -- an exemption that allows the two carriers to coordinate marketing plans, services, prices, and route strategy and to integrate facilities and personnel to produce economic benefits to both carriers. It is not surprising that Northwest's President has stated that antitrust immunity is one of his company's most valuable "strategic assets," benefiting its bottom line to the tune of tens of millions of dollars a year. Aviation Daily, August 9, 1994, p. 226. In fact, the **KLM/Northwest** alliance increased traffic over Northwest's flights by about 200,000 passengers in 1994. GAO Report, p. 27. The combined market share of KLM and Northwest increased from 7 percent before the alliance to 11.5 percent in 1994. GAO Report, p. 30. The antitrust immunized alliance infused up to \$175 million in added revenues to Northwest in 1994 alone, one-third of **Northwest's** total transatlantic passenger revenues. GAO Report, p. 28. KLM earned \$100 million in added revenues, equal to 18 percent of its transatlantic passenger revenues. Id. GAO found that "[t]he alliance's success is due to the broad scope of the code-sharing network and the degree of integration the airlines have **achieved**," which was made possible by antitrust immunity. GAO Report, pp. 28-29.

The proposed American/Canadian Commercial Alliance Agreement is fully consistent with the Department's policy to encourage and facilitate the globalization and cross-networking of air transportation. As Secretary **Pena** stated when he unveiled the U.S. International Aviation Policy Statement, "[t]he process of globalization -- a phenomenon we have seen in telecommunications, banking and many other industries -- is now well underway in the world's airline industry" (Remarks of Secretary **Pena**, November 1, 1994, at the 50th Anniversary Commemoration of the Chicago Convention, p. 4). The Secretary further noted that "the United States believes that globalization will bring vast benefits for all nations and air carriers that embrace and adapt to it," and that the new International Policy Statement "places the power of the United States Government firmly behind the movement to...increased international traffic and the growth of global networks." *Id.*, pp. 3, 6. See also Statement of Secretary **Pena** before the Senate Commerce Committee on July 11, 1995: "Our policy statement recognizes that the trend towards globalization of air services through efficiency-enhancing networks and alliances is here to stay, and that this development offers great public benefits for all nations."

Secretary **Pena** correctly observed that globalization necessarily involves the linkage of hub networks:

"The U.S. airline industry's experience under domestic deregulation has clearly shown the airlines of the world the need to build efficient networks to deliver better service and more access to markets of all sizes. Now, the hub-and-spoke networks that already exist on different continents can be linked to permit more efficient service to hundreds of new international markets -- markets that are not large enough by themselves to support direct air service" (Remarks of Secretary **Pena** at 50th Anniversary Commemoration of Chicago Convention, p. 4).

He noted that the "ability to effectively flow passenger traffic between [U.S. carriers'] own and others' networks . . . enable[s] carriers to provide much improved, more competitive services to millions more travelers and shippers every year." Id.

The final U.S. International Aviation Policy Statement issued in April 1995 reflects U.S. Government policy to support efficiency-enhancing global alliances such as the one proposed here. The following excerpts from the Policy Statement express the importance to the public interest of interconnecting international hub networks:

"The rapid growth of demand for international air service and the wider dispersion of traffic in city-pair markets are primary factors influencing the development of the air service industry. Carriers are increasingly finding that they cannot remain profitable unless they can respond to this changed demand. To compete effectively, carriers today must have unrestricted access to as many markets and passengers as possible.

"To meet demand and to improve their efficiency, many carriers are developing international **hub-and-spoke** systems that permit them to combine traffic flows from many routes (the '**spokes**') at a central point (the '**hub**') and transport them to another point either directly or through a hub in another region. Just as U.S. carriers developed hub-and-spoke systems to tap the broad traffic pool in the domestic market and to provide the most cost-efficient service for hundreds of communities that could not support direct service, international air carriers are developing world-wide hub-and-spoke systems to tap the substantial pool of international **city-pairs**. Internationally, an even larger portion of traffic moving over hub-and-spoke systems will require the use of at least two hubs (**e.g.**, a hub in both the U.S. and Europe for a passenger moving from an interior U.S. point to a point beyond the European hub). This increases the complexity and interdependence of the components of the system (both the spokes and hubs) and the importance of multinational traffic rights to the success of the system.

"As a result, carriers wishing to establish global networks require a higher quality and quantity of supporting route authority than they have sought in the past. Airlines will become increasingly concerned with every market that enables them to flow passengers over any part of their system network. These airlines will be looking for broad, flexible authority to operate beyond and behind hub points, in addition to the hub-to-hub market between two countries.

* * *

"In short, as indicated by our domestic experience, a variety of service forms -- global networks with carriers participating either as the sole provider or as participant in a joint network, and regional niche carriers -- can exist in the international aviation market, and the competition among these services will enhance consumer benefits through efficient operations and low fares. Thus, our international aviation strategy should provide opportunities for all of

these forms of service so that we realize the benefits from maximum competition among **them**" (DOT Policy Statement, 60 Fed. Reg. 21842, 21843).

Thus, U.S. international aviation policy encourages and supports the alliance proposed in this Joint Application, which will create **"a new network-building technique: [a] cross-border marketing alliance that link[s] traffic flows between established hub-and-spoke systems in key cities."** DOT Policy Statement, 60 Fed. Reg. 21842. By allowing the Joint Applicants to establish a pro-competitive global alliance linking their respective U.S. and Canadian networks, the Commercial Alliance Agreement is consistent with and will advance the Department's U.S. international aviation policy.

When the Department approved and immunized the KLM/Northwest combination, it anticipated that the grant of antitrust immunity would not only encourage, but necessitate the development of other similar alliances:

"We look to our Open Skies Accord with the Netherlands and our approval and grant of antitrust immunity to the [Northwest/KLM] Agreement to encourage other... countries to liberalize their aviation services so that comparable opportunities may become available to other U.S. carriers" (Order 92-11-27, p. 14).

That invitation has been accepted by Canada, which has entered into a greatly liberalized aviation agreement with the United States. The Joint Applicants now stand ready to make use of the competitive opportunities under this new

agreement, which can only be fully realized by the grant of this application.

Furthermore, as discussed below, approval of the Joint Application will be consistent with established Department precedent as set forth in the orders approving and granting antitrust immunity for the commercial cooperation and integration agreement between KLM and Northwest. The Commercial Alliance Agreement here is similar in scope to the **KLM/Northwest** agreement. The Department concluded in Orders 92-11-27 and 93-1-11 that the KLM/Northwest agreement would be pro-competitive and would produce efficiencies, and that "the grant of immunity should promote competition by furthering our efforts to obtain less restrictive aviation agreements with other... countries" (Order 93-1-11, pp. 11-12). The same conclusion applies with equal force to the Commercial Alliance Agreement here. Conversely, the denial of antitrust immunity would prevent consummation of the Commercial Alliance Agreement, and thereby deny the public the substantial benefits otherwise obtainable.

Uniform, consistent, and fair application of regulatory policy requires the Department to accord the same legal authority to the Joint Applicants (i.e., antitrust immunity) as accorded to **KLM/Northwest** to allow them to compete on a level playing field with that alliance in the global marketplace.

This would be consistent with the new U.S. International Policy Statement to "ensure that competition is fair and the playing field is **level**" (60 Fed. Reg. 21844). The Department should not perpetuate a two-class system where only one alliance enjoys unique antitrust treatment not available to other alliances involving carriers from countries with liberalized regimes.

B. Foreign Policy Considerations Support Approval Of
And Grant Of Antitrust Immunity To The American/
Canadian Commercial Alliance Agreement

In KLM/Northwest, the Department concluded that "**the** public interest requires antitrust immunity for foreign policy reasons, particularly our bilateral relationship with the Netherlands." Order 93-1-11, p. 12. Even though the Department stated that "**the** [U.S. -Netherlands] Accord by its terms does not mandate a grant of antitrust immunity in this **case**," the Department found that "denial of antitrust immunity would contravene the spirit of the Accord and be counterproductive to the United **States'** relations with the Netherlands.... We believe that the Netherlands would consider a denial of immunity to be contrary to the Open Skies Initiative, unless we had a

strong basis for a refusal to grant antitrust immunity." Id.¹

Moreover, the Department found that:

"[W]e would expect that our willingness to take such action [granting antitrust immunity] might well encourage other countries to seek liberal aviation arrangements with the United States... so that comparable opportunities may become available to other U.S. carriers" (Order 92-11-27, pp. 12, 14).

The GAO Report correctly observed that the Department's approval of KIM/Northwest antitrust immunity "implied a favorable treatment of future applications by other U.S. and

1 See also Order 92-11-27, p. 17, in which the Department stated:

"We recognize that the accord between the United States and the Netherlands does not expressly require us to grant a request for approval and antitrust immunity of an agreement on integrating the services of a U.S. carrier and a Dutch carrier. However, we have found that the Agreement is likely to benefit the traveling public in many markets and is unlikely to reduce significantly competition in any market, except perhaps for the two markets served by the applicants under their current blocked-space arrangement. Since the Agreement overall should benefit the public, it would be contrary to the spirit of the accord with the Netherlands to disapprove it (or to prevent its consummation by denying antitrust immunity). We believe that the Netherlands would consider it to be inconsistent with the Open Skies spirit if we denied the applicants' request, unless we had substantial grounds for taking such action (e.g., because the proposal would substantially reduce competition in several markets without any offsetting benefits)."

foreign airlines in exchange for liberal aviation accords" (p. 52).

Against this precedential backdrop, the Government of Canada entered into a landmark liberalized agreement with the United States. In the preamble to their new Air Transport Agreement, the two Governments recognized **"the** importance of efficient air services for trade, tourism, and investment flows," and expressed their desire **"to** conclude an agreement for the purpose of promoting transborder commercial air services to the fullest possible extent;...to promote a liberal international aviation system;...[and] to promote fair and equal opportunities for airlines to compete in the marketplace with minimum government regulation." As Secretary **Pena** has stated, the new agreement is **"a** huge breakthrough -- even in global terms.... **[I]t** has freed up the largest single bilateral aviation market in the world, with more than 13 million cross-border passengers a year.... We confidently expect to see dramatic growth in airline service and travel options that will benefit travelers and airlines in both **nations.**" See Speech Before the International Aviation Club, Washington, D.C., March 7, 1995.

The Secretary's stated expectations for U.S.-Canada air service are amply borne out by the facts. Within nine months of completion of the new bilateral, **transborder** service

increased by nearly 60 percent, from 1,904 to 3,040 weekly roundtrip frequencies (see Exhibit JA-3). Both the size of this market and its dramatic growth far **outpace** to the experience following the amended U.S.-Netherlands bilateral. One year after the U.S.-Netherlands bilateral was amended, service increased only 23 percent, from 90 to 111 weekly round trip frequencies. It is evident that the benefits of the liberalized Canadian bilateral greatly exceed the public and foreign policy benefits of the U.S.-Netherlands agreement. Nevertheless, realization of the full benefits of the Canadian bilateral will fall far short without immunity to allow the Joint Applicants to form an alliance that can compete effectively in U.S.-Canada transborder markets and in the global marketplace.

The Joint Applicants submit that disapproval of the Commercial Alliance Agreement or the prevention of its consummation by withholding immunity would contravene the spirit and intent of the liberalized U.S.-Canada Air Transport Agreement, as well as the basic tenets of the North American Free Trade Agreement to "eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties. ..[and] promote conditions of fair competition in the free trade **area.**" NAFTA, Article 102, Section 1.(a),(b). Such action would be inconsistent with the U.S. Government's commitment to open skies and free and fair

international competition, and to the Department's promise of "comparable opportunities" in exchange for open skies. Just as the Department found that Section 1102(a) of the Federal Aviation Act (now 49 USC 40105(b)) required approval of the **KLM/Northwest** alliance based on the spirit of the U.S.-Netherlands accord, for the same reasons it would be contrary to the spirit of the North America Free Trade Agreement, the liberalized aviation agreement with Canada, and the expectations of the Canadian Government for the Department to disapprove the pro-competitive Commercial Alliance Agreement at issue here, or to prevent its consummation by denying antitrust immunity absent overwhelming reasons to the contrary.

C. The Statute And The Department's Well-Established Precedents Support Approval Of The American/Canadian Commercial Alliance Agreement

The statute provides that the Department **"shall** approve an agreement...when the Secretary finds it is not adverse to the public interest and is not in violation of this **part,"** 49 USC 41309(b). The Department is required to disapprove an agreement that "substantially reduces or eliminates **competition**" unless the Department finds that the agreement satisfies a more rigorous public interest standard, i.e., that the agreement is "necessary to meet a serious transportation need or to achieve important public benefits (including international comity and foreign policy **considerations**)," and

"the transportation need cannot be met or those benefits cannot be achieved by reasonably available alternatives that are materially less anticompetitive, 49 USC 41309(b)(1)(A),(B).

The American/Canadian Commercial Alliance Agreement will further U.S. foreign policy objectives and enhance competition, and will not have the effect of substantially reducing or eliminating competition. Consequently, the Commercial Alliance Agreement fully meets the public interest test in 49 USC 41309(b).

1. The Proposed Alliance Will Not Substantially Reduce Or Eliminate Competition On **Any** Route

The Department has in the past examined both the U.S.-foreign country market and overlapping city-pairs in determining the competitive effect of a proposed transaction. As we show below, the American/Canadian alliance will not substantially reduce or eliminate competition between the United States and Canada, or on any overlapping city-pair route.

a. United States-Canada

The effects of the proposed Commercial Alliance Agreement in the U.S. -Canada market will be substantially less anticompetitive than the effects the Department found with respect to the U.S. -Netherlands market when it approved the KLM/Northwest combination in 1993. In that proceeding, the Department determined that there would be no adverse competi-

tive effects in the country-to-country markets despite the creation of a dominant market share:

"In the United States-Netherlands market, **KLM** and Northwest will have a dominant market share. **KLM**, after all, is the major scheduled carrier in the Netherlands. Nonetheless, we do not believe that the proposed integration will enable the applicants to charge supra-competitive prices or to reduce service below competitive levels.

"Even if a merger creates a firm with a dominant market share, the merger would not substantially reduce competition if other firms have the ability to enter the market within a reasonable time if the merged firms charged supra-competitive prices. Despite the dominant position of KLM in the U.S.-Netherlands market, we see no barriers to entry by other carriers in that **market**" (Order 92-11-27, p. 15).

By contrast, Canadian is not the "**major** scheduled carrier" in Canada but rather faces strong competition from Air Canada which dominates both domestic Canada and **transborder** routes. Thus, the present application affords the Department the unique opportunity to provide the pro-consumer benefits of seamless code-sharing, and to bolster competition by strengthening the rival of a dominant foreign carrier.

The proposed transaction will not harm competition in the U.S.-Canada market which, with 32 carriers offering nonstop service, is less concentrated than any other country-to-country market in the world. In addition, there are a host of convenient one-stop on-line connecting services provided by carriers

of both countries over numerous gateways on both sides of the border (see Exhibit JA-4).

The proposed alliance will not significantly increase concentration in the country-to-country market because of Canadian's small share of transborder frequencies. In the transborder market, Canadian, at 5.4 percent, is a fraction of the size of Air Canada, which has a commanding 25 percent share (see Exhibit JA-2). Moreover, with the exception of Air Canada's dominance, the transborder market is otherwise marked by healthy competition, with the next 10 largest carriers capturing market shares ranging from 8.6 percent to 4.0 percent.

While the combination of the market shares for American and Canadian would increase concentration slightly, this does not raise significant competitive concerns. Taken together, American and Canadian will have 14 percent of the total transborder frequencies, a distant second behind Air Canada. Thus, the principal effect of the alliance is to reshuffle the rankings, not to increase overall concentration.

Calculating the HHI Index numbers shows that the transborder market is "somewhat concentrated," with a **pre-**alliance index of 1,000 (see Exhibit JA-5). However, 616 points of that index are attributable to the dominant position of a single carrier, Air Canada. Moreover, the post-alliance

concentration index is 1,093, representing an increase of only 93 points. Under Justice Department guidelines, if this were a merger, it would not likely be challenged since the post-merger HHI is substantially less than 1,800, and the transaction increases the HHI by less than 100 points. Further, the proposed alliance will strengthen Canadian, allowing it to compete more effectively with Air Canada, without harming competition through increased concentration.

In addition to strong competition from Air Canada, any potential for market power will be mitigated by the opportunity for new entry, just as the Department found in the case of KIM/Northwest. The U.S.-Canada Air Transport Agreement permits unrestricted entry into any transborder route for carriers of Canada. Similarly, U.S. carriers in effect have open access to serve every city in Canada, with the exception of Toronto, which is addressed in the city-to-city discussion **below.**² Thus, country-to-country competition will be amply preserved by existing actual competition as well as the potential for new entry.

² The agreement set temporary limits on U.S. carrier access to Vancouver and Montreal for a period of two years, and to Toronto for a period of three years. As a practical matter, the restrictions at Vancouver and Montreal are not preventing U.S. carriers from entry, since there are sufficient opportunities to satisfy demand.

As an illustration of the greater competition in the U.S.-Canada market compared to other country-to-country markets, it is unlikely that American and Canadian can expect to operate any significant transborder segment as a duopoly, because of Air Canada's dominant size and new entry opportunities. This contrasts sharply with the KLM/Northwest alliance, where the Department conceded the likelihood that the two carriers would dominate the U.S.-Netherlands market and monopolize two key routes. The Department nevertheless granted immunity, relying on the theoretical potential for new entry to overcome market power in the country-to-country market. The facts here are far more compelling that the proposed American/Canadian alliance will not substantially reduce competition between the U.S. and Canada because Air Canada and major U.S. carriers already vigorously compete, and the liberal bilateral agreement affords ample new entry opportunities.

b. City-Pair Overlaps

Just as in the KLM/Northwest alliance, there are two true overlapping city-pairs in the proposed American/Canadian alliance where both carriers operate aircraft: New York (**LGA**)-Toronto and **Chicago-Toronto**.³ Although the new U.S.-Canada

³ Effective November 1, 1995, American has implemented new service from Tampa to Toronto. Canadian operates from St. Petersburg to Toronto. These routes may be viewed as additional overlapping service. However, Air Canada operates the same number of daily frequencies between Tampa and Toronto

Air Transport Agreement temporarily limits new entry by U.S. carriers into Toronto, under the unique circumstances of the Canada aviation market, this limitation makes immunizing the alliance a procompetitive necessity. Rather than limiting competition at Toronto, the new bilateral agreement has in fact sparked fierce competition which undoubtedly benefits consumers.

The New York (LGA)-Toronto market now has enormous capacity with 24 daily jet frequencies, as Air Canada responded aggressively to code-sharing by American and **Canadian**.⁴ In order to meet Air Canada's challenge, American and Canadian must have a fully cooperative relationship, immunized from antitrust risk, to offer fully competitive service and marketing programs. Otherwise, they will not be able to offset Air Canada's overwhelming market power which would only become more entrenched during the bilateral agreement's phase-in period.

Chicago-Toronto is now served a total of 18 times per day by four carriers: Air Canada, United, Canadian, and American. Air Canada and United have announced their intention to code-share in this city-pair, combining Air Canada's market

(two) as the combined frequencies of American and Canadian in the two city-pairs, Tampa-Toronto and St. Petersburg-Toronto.

⁴ This does not include the additional six daily frequencies that Air Canada operates between Newark and Toronto.

power at Toronto with United's hub strength at Chicago. The Department approved such code-sharing by Order 95-10-27, October 17, 1995. Again, the only plausible competitive offset during the phase-in period is a fully cooperative joint venture of American and Canadian, immunized from the risk of antitrust exposure.

Thus, the proposed American/Canadian alliance is **pro-**competitive, because it establishes the sole realistic alternative to Air Canada's dominance in the New York (LGA)-Toronto and Chicago-Toronto city-pair markets. Further, the American/Canadian overlapping city-pairs have none of the anticompetitive potential of the overlapping city-pairs in the **KLM/Northwest** alliance. In granting antitrust immunity to KLM and Northwest, the Department recognized that they might exercise market power in the Detroit-Amsterdam and Minneapolis/St. Paul-Amsterdam markets without attracting new entry. Indeed, the Department said that "[w]e doubt that any other carrier would be particularly interested in providing nonstop service between Amsterdam and either Detroit or Minneapolis/St. Paul if the applicants charged supra-competitive prices, since no carrier besides Northwest has a hub at either U.S. gateway" (Order 92-11-27, p. 16). In contrast, American and Canadian face fierce competition with the stronger Air Canada in the New York (LGA)-Toronto city-pair and with the recently approved

code-sharing combination of Air Canada and United in the Chicago-Toronto city-pair.

Exhibit JA-6 shows the alternative transborder services currently available in competition with the proposed alliance's gateways, including the two overlapping city-pairs. This demonstrates that there are ample competitive alternatives for consumers, and that the proposed Commercial Alliance Agreement will not significantly increase concentration on any route. Further, the key city-pairs have seen substantial increases in service since the new Air Transport Agreement entered into force last February. In both cases, there is direct competition from alternative nonstop services that match the combined frequency of American and Canadian.

Of the two overlapping U.S. gateways served by the alliance carriers, only one, Chicago, is a hub for American. Chicago is also a hub for United which, because of its slot advantage, operates substantially more service than American. At the other gateway, New York (LGA), there are a host of other carriers providing nonstop service to Canada (see Exhibit **JA-6**). With respect to both Chicago and New York, there is substantial new capacity to transborder destinations. Direct price discipline will be forced on the proposed American/Canadian alliance by alternative nonstop service, resulting in far greater competition than the indirect price discipline from

less convenient one-stop and connecting services in the KLM/Northwest overlapping city-pair markets.

With respect to behind-Chicago/New York passengers, there are a substantial number of competitive gateways in the U.S. and Canada over which passengers can and do connect for transborder service, in addition to alternative competitive service through the identical gateways (see Exhibit JA-6). Thus, the Department's conclusion in KLM/Northwest applies even more strongly here: **"the** fares and service offered [by] them should continue to be disciplined by the connecting services offered by the applicants' competitors" (Order 92-11-27, p. 16).

The Department would undermine the potential efficiency benefits of the proposed Commercial Alliance Agreement if it excluded or limited antitrust immunity with respect to the two overlapping markets. The overlapping city-pairs serve as bridges to link the carriers' respective networks. It would be impossible to carve out the bridges from the immunity given the interdependence of the bridges to the network-to-network **system**. In KLM/Northwest, the Department considered and rejected carving out the overlapping city-pairs from the antitrust relief it granted, concluding that **"such** an exclusion would be impracticable, given the applicants' stated intent to integrate all of their operations and the dependence of their

services in those markets on the flow of connecting traffic" (Order 92-11-27, p. 16). Nor would it be workable to confine the antitrust immunity only to the overlapping city-pairs:

"[g]iven the interrelations between [the overlapping] routes and the rest of the applicants' systems, it would not be feasible to confine the immunity to matters involving the [overlapping] **routes**" (Order 93-1-11, p. 13).

2. The Joint Application Meets The Department's Standards For Grant Of Antitrust Immunity

The Department has the discretion to grant antitrust immunity to agreements approved under 49 USC 41309 if it finds that the immunity is required by the public interest. The Department's established policy is to grant antitrust immunity with respect to agreements that are found not substantially to reduce or eliminate competition, if the Department concludes that antitrust immunity is required in the public interest and the parties will not proceed with the transaction absent antitrust immunity. Order 92-11-27, p. 18; Order 93-1-11, p. 11.

a. Grant Of Antitrust Immunity Is Required In The Public Interest

The Commercial Alliance Agreement would allow the carriers to capture the synergies of their respective route networks, establish a seamless air transport system through network-to-network combinations, achieve competitive economies of scale, and enhance competition. These benefits would result

in lower costs and enable the alliance carriers to serve more efficiently thousands of city-pairs and thus provide the public with more service options at less cost. Furthermore, the Commercial Alliance Agreement would permit American and Canadian to compete more effectively against larger networks created by the rival alliances forged by Air Canada with both United and Continental.

The American/Canadian Commercial Alliance Agreement is virtually identical to the **KLM/Northwest** Commercial Cooperation and Integration Agreement which was approved by DOT in 1993. That agreement formed the basis of the **KLM/Northwest** global alliance. DOT concluded that the **KLM/Northwest** combination would be pro-competitive (even though there were overlapping city-pairs in which KLM and Northwest competed) and that antitrust immunity would produce efficiencies and "**should** promote competition by furthering our efforts to obtain less restrictive aviation agreements with other European countries" (Order 93-1-11, pp. 11-12). The same conclusion applies with equal force here.

The Commercial Alliance Agreement will allow American and Canadian to develop mechanisms to enhance efficiencies, reduce costs, and provide better service to the traveling and shipping public in the following illustrative ways:

1. Increased Frequencies and Enhanced On-Line Service. The integration and coordination of the multi-hub networks of the alliance carriers on both sides of the **U.S.-** Canadian border will generate greater levels of traffic support. With enhanced traffic flows, the alliance carriers will be able to expand frequencies over transborder segments. Furthermore, by interconnecting the multiple hubs of the alliance carriers, the alliance will be able to link American's extensive domestic U.S. network from 171 cities in the U.S. with the Canadian network. The alliance will have the potential to offer on-line service (i.e., either single-plane and/or connecting service) to over 20,000 city-pair routes between the United States and Canada. Such service enhancements and expanded on-line service options can only be accomplished on an efficient basis through coordination and integration of schedules, combined network planning, and the establishment of a common financial objective.

2. Expanded Access for American and Canadian in Behind Gateway Markets. The creation of joint services having a common financial objective is essential to the alliance carriers' ability to expand on-line service, particularly in behind and beyond gateway markets. The establishment of service with a common financial bottom line, involving marketing, sales, prices, and the allocation of revenues and **earn-**

ings, cannot be accomplished without antitrust immunity. In the absence of immunity, competitors cannot discuss and agree to network coordination and must develop prorated arrangements in the context of "arms-length" negotiations to divide revenues among the transborder and behind/beyond segments. Such an arms-length process is cumbersome and, in the absence of a common financial objective, effectively forecloses access to behind-U.S. and behind-Canada gateway cities. The GAO Report on airline alliances concluded that "[w]ith immunity, Northwest and KLM can develop formulas to set fares in all markets and, according to Northwest and KLM representatives, quickly enact fare reductions to attract traffic." GAO further observed that "[w]ithout immunity, airlines that are significant competitors cannot discuss pricing issues and must develop prorated agreements in 'arm's length' negotiations to divide revenues, a cumbersome process when thousands of city-pairs are involved" (p. 29). Antitrust immunity will permit the alliance carriers to negotiate prorates, divide revenues, and gain access to each others' behind-gateway city-pairs.

3. Coordinated Hubs and Transborder Segments. An immunized alliance will be able to offer a greater variety of transborder services. The alliance will be able to coordinate the respective hub networks and the transborder segments of the applicant carriers to achieve more efficient service and

maximize service options for the traveling and shipping public. The alliance carriers wish to coordinate their multi-hub networks in the same way that American currently coordinates its domestic system over its U.S. hubs. In the absence of immunity, the carriers must independently schedule their services to maximize their own individual positions. An antitrust-immunized alliance arrangement will establish common economic objectives that will allow the joint applicants to combine their resources to a greater degree than they can today to operate additional transborder services that would not be economically feasible in the absence of immunity.

In addition, coordinated scheduling will allow for a greater variety of behind-gateway services. For example, assume that American and Canadian each serve a third country and schedule their flights to arrive at that country at about the same highly desirable peak hour. If American were to **code-share** with Canadian for service from the United States to that country, in the absence of immunity and coordinated scheduling, American would offer two frequencies -- but it is likely that both of them would arrive at approximately the same time. This pattern would not provide a variety of different service options for the traveling and shipping public. However, if the carriers have the ability to coordinate their services according to a common economic objective and combine the **synergies** of

their respective networks, the carriers could revise and add to their schedules to provide, for example, different arrival and departure times. The result would be a broader array of on-line service options for both U.S. and Canadian travelers. The coordination will produce highly efficient and expanded service by the alliance carriers. However, in the absence of antitrust immunity, such an arrangement might expose the carriers to the risk of antitrust challenge.

4. Expansion of Discount Fares. Currently, each carrier offers deep discount on-line fares that are only available for travel on that carrier's system. The common financial objective of the alliance will enable the alliance carriers to expand the availability of such deep-discount fares to additional on-line services.

5. Availability of Discount Seats on Transborder Segments. The common financial objective of the alliance arrangements will also enable the alliance airlines to provide greater levels of discount seats than might otherwise be available in the absence of the immunized alliance. Under their current arms-length code-share arrangement, each carrier's incentive is to maximize the return on each seat operated. Consequently, if demand is high, neither carrier has the incentive to release seats to its code-share competitor for resale by that carrier. The common financial "**bottom line**" and

the coordinated pricing component of the proposed arrangement will permit the alliance carriers jointly to fill seats at price-efficient levels.

6. Inventory Control. The coordinated alliance can develop uniform and coordinated control of seat inventory to maximize management of capacity, thereby increasing utilization and efficiency, and reducing costs for the benefit of the traveling public.

7. Reduced Sales, Marketing, and Reservations Costs. The alliance will permit the carriers to maximize economic efficiencies by coordinating sales, marketing, reservations, and airport services and reducing redundant costs in those areas.

a. More Effective Equipment Utilization. The alliance will permit the carriers to maximize utilization of their aircraft. By coordinating their services, the alliance carriers will be able to optimize the use of aircraft on routes where demand is higher and utilize smaller equipment on thinner routes.

The experience to date of the KLM/Northwest alliance is highly informative and demonstrates that the immunized joint enterprise produces substantial increased on-line service benefits to the traveling and shipping public and **sizeable** efficiencies/earnings benefits to the joint enterprise. The

GAO Study on airline alliances observed that the substantial degree of integration between **KLM** and Northwest allowed the linkage between Northwest's domestic hubs and **KLM's** European hub, permitting an expanded network of on-line services between 88 U.S. cities served by Northwest, on the one hand, and 30 European/Middle Eastern cities served by KLM, on the other hand. We calculate that the Northwest-KLM alliance has the potential to serve over 32,000 international city-pairs. As a consequence of enhanced on-line services, KLM passengers traveling on Northwest's aircraft increased by 115 percent (nearly 200,000) from 1991 to the year ended June 1994. GAO Report, p. 27. Thus, as the GAO Report noted, "Northwest's data indicate that for the year ended June 1994, over 353,000 passengers traveled on Northwest aircraft as part of the alliance, compared to 164,450 passengers traveling on connecting Northwest and KLM interline flights in **1991.**" Id.

The GAO Report further indicates that the alliance allowed Northwest to add to its system 30 overseas cities that it would not otherwise have served in the absence of the immunized alliance (p. 28). The GAO Report pointed out that the combination produced economic benefits for both airlines: "**We estimate** that the alliance produced between \$125 million and \$175 million in added revenues for [Northwest] in **1994,**" representing "**about** one-third of Northwest's \$455 million in

transatlantic passenger revenues and about 5 percent of its \$3 billion in total international passenger revenues in 1994" (p. 28) .

The proposed coordinated activities among the Joint Applicants would, in the absence of antitrust immunity, expose them to antitrust risk. Business prudence dictates that the alliance carriers are not willing to take the risk that the activities pursuant to the Commercial Alliance Agreement would be challenged by third parties asserting such actions to be unlawful under the antitrust laws. Consequently, the grant of antitrust immunity for the Commercial Alliance Agreement is absolutely essential in the public interest and necessary to allow the parties to proceed with the proposed transaction.

b. The Joint Applicants Will Not Proceed With The Commercial Alliance Agreement In The Absence Of Antitrust Immunity

Under the Department's long-standing precedent, antitrust immunity will not be granted to agreements that would not violate the antitrust laws, unless the parties refuse to implement the agreement without immunity. See Order 92-11-27 (KLM/Northwest). The Joint Applicants categorically state that they will not carry out the full collaboration, coordination, and integration contemplated by the Commercial Alliance Agreement in the absence of antitrust immunity because of the

substantial risk that the Joint Applicants could be subject to costly and lengthy antitrust litigation.

The Commercial Alliance Agreement contemplates joint sales/marketing activities, price and capacity coordination, and schedule coordination/integration across their entire combined networks, including the overlapping routes. The applicants firmly believe that these arrangements will create service enhancements and produce efficiencies that could not be achieved in the absence of the Commercial Alliance Agreement. However, absent the grant of immunity, there is no assurance that the alliance would not be challenged on antitrust grounds. This very real threat of a challenge would chill the alliance and reduce its benefits to the traveling and shipping public. As the GAO Report notes:

"[DOT and DOJ] officials stated that they believed the key benefit of immunity [in the Northwest-KLM case] is the protection from legal challenge by other airlines, thereby allowing Northwest and KLM to more closely integrate their operations and marketing than they otherwise would for fear of legal reprisal" (GAO Report, p. 30).

In short, the extensive discussions and coordination necessary to meld the Joint Applicants' networks will not occur without antitrust immunity, because the applicants are not willing to incur the risk of an antitrust challenge.

C. The Approval Of And Grant Of Immunity For The
Commercial Alliance Agreement Will Accelerate
Full Liberalization Of The International
Marketplace

American, as the U.S. partner in the proposed alliance, points out that approval of the Commercial Alliance Agreement and the grant of an antitrust exemption will accelerate the U.S. Government's ability to achieve liberal open skies agreements with other countries -- including those with currently restrictive aviation policies -- so that "comparable opportunities" may become available to other U.S. carriers in the context of a broadly liberalized international marketplace. See Order 92-11-27, p. 14.

Real competitive pressure in the marketplace is required to effect a change in restrictive aviation policies. Approval of the Commercial Alliance Agreement coupled with antitrust immunity would create just such a competitive prod and help establish the economic and political imperatives necessary to encourage restrictive foreign aviation powers to open their markets so that carriers from those countries may also enjoy the benefits of global service networks. As the GAO Report pointed out, "antitrust immunity could be a powerful incentive for governments -- which are often seeking to benefit one national flag carrier -- to eliminate their restrictions on U.S. airlines" (p. 54).

The Department had hoped that the U.S. Open Skies Agreement with the Netherlands and the **KLM/Northwest** Alliance would "encourage other...countries to agree to liberalize their aviation services so that comparable opportunities may become available to other U.S. carriers." Order 92-11-27, p. 14. The success of the **KLM/Northwest** alliance has encouraged Canada to move toward an Open Skies accord and has precipitated the American/Canadian alliance. This alliance will, in turn, increase the pressure on other governments to break down their protectionist walls.

IV. OTHER APPROVAL ISSUES

A. CRS

Consistent with the Department's holding in **KLM/Northwest**, the grant of antitrust immunity should also cover the coordination of (1) the presentation and sale of the carriers' airline services in **CRSs**, and (2) the operations of their respective internal reservations systems. In the **KLM/Northwest** approval, the Department determined that, while the coordination of CRS activities could arguably reduce competition, the competitive concern was not so significant as to outweigh the justification for grant of antitrust immunity. The same conclusion applies with equal force here. See Order 93-1-11, p. 15.

B. Duration Of Approval

The Joint Applicants request that the Department grant the requested approval and immunity for a five-year term, consistent with the duration of approvals granted by the Department to **KLM/Northwest** in Order 93-1-11 and Order 92-11-27. As the Department concluded in **KLM/Northwest**, "a shorter term may not allow the full effect of the implementation of the Agreement to become apparent. Furthermore, Section 414 [now 49 USC **41308**] does not require us to review the implementation of the Agreement within a shorter period of **time**." Order 93-1-11, p. 16.

V. RESPONSE TO ADDITIONAL INFORMATION REQUIREMENTS
IMPOSED IN DELTA PROCEEDING IN DOCKET OST-95-618

By Order 95-9-27, September 25, 1995 in the Delta/Swissair/Sabena/Austrian Airlines immunity proceeding, the Department required the joint applicants to provide certain additional information. In order to expedite the Department's review and consideration of the American/Canadian joint application, we are submitting the following similar information.

A. Provide all American and Canadian corporate documents dated within the last two years that address competition in the U.S.-Canada markets:

The requested documents are being filed separately by American and Canadian, accompanied by a joint motion for confidential treatment under 14 CFR 302.39.

B. Provide all American and Canadian studies, surveys, analyses, and reports dated within the last two years which were prepared by or for any officer(s) or director(s) (or individual(s) exercising similar functions) for the purpose of evaluating or analyzing the proposed enhanced alliance with respect to market shares, competition, competitors, markets, potential for traffic growth or expansion into geographic markets, and indicate (if not contained in the document itself) the date of preparation, the name and title of each individual who prepared each such document:

The requested documents are being filed separately by American and Canadian, accompanied by a joint motion for confidential treatment under 14 CFR 302.39.

C. Describe separately each applicant's strategic objectives in forming the alliance agreement:

American. By extending its network through an alliance agreement with Canadian, American seeks to increase its passenger and cargo revenues by capturing additional traffic in two types of routes: (1) U.S.-Canada O&D routes that have not previously enjoyed on-line service, and (2) the U.S. domestic segments of routes between the U.S. and Asia and Europe via Canada.

Canadian. Similarly, Canadian seeks to increase its revenues in transborder segments and in selected routes beyond the United States.

D. Describe the impact that implementation of the proposed alliance asreement would have on American's operating revenue and **operating** and net profit and loss results:

The American/Canadian alliance forms an important part of American's North American strategy. Although additional revenues and profits generated as a result of the alliance agreement will be modest compared to total American revenues and profits, the alliance is of substantial strategic and financial importance.

E. Provide forecast information and data **concerning** any traffic diversion anticipated from U.S. **flag** Carriers should the application be approved:

We have not previously prepared any forecasts of traffic diversion from U.S.-flag carriers. We do not believe that reliable forecasts could be prepared, because of the absence of historical data on the open transborder market; the new U.S.-Canada Air Transport Agreement is less than nine months old, and most new services have only been operated for a short time.

F. Discuss whether and to what extent a grant of the application would or should affect the joint applicants' participation in IATA, especially price coordination:

American voluntarily and unilaterally withdrew from the IATA Passenger Tariff Coordinating Conference in late 1994. Although effective immediately, this action will be formally recognized by IATA effective January 1, 1996. Furthermore, U.S.-Canada markets have never been included in IATA tariff coordination activities. We do not expect that granting the application would have any impact on either American's or Canadian's participation in any other IATA activities.

G. Provide Origin & Destination (O&D) traffic for 1994 for Canadian's top 100 markets that involve a U.S. gateway city as a passenger origin or destination point:

The requested information is being filed separately by Canadian, accompanied by a joint motion for confidential treatment under 14 CFR 302.39.

H. In addition to the information requested in the immediately preceding item, provide an analysis of the effect on international and U.S. domestic competition of the proposed closer arrangements between the applicants:

Approval of the application will have a positive impact on international and domestic competition. Granting the application will make it possible for American to make more

productive use of its resources, and enhance its viability. This necessarily strengthens domestic competition. Nevertheless, the transaction will result in only a modest change in the size of American's overall system, and it is unlikely that competition in the domestic airline industry will change significantly as a result of approval of this application.

With respect to international competition, the granting of this application will enable American and Canadian to compete more effectively with Air Canada, by far the leader in the U.S.-Canada air travel market, and will also enable American and Canadian to better compete in many intercontinental markets, especially between the U.S. and Asia.

I. Describe the extent to which airport facilities, including gates and slots, are available to other carriers who want to **begin** or increase service at major Canadian airports served **by** Canadian:

We are unaware of any constraints on gates and slots at major Canadian airports. As the Department is aware, Pearson International Airport in Toronto has nominal slot filing requirements, but these do not restrict entry. Moreover, a new runway is currently under construction there, and terminal facilities are readily available. At Vancouver International Airport, a new international terminal will open on June 1, 1996 which will also serve transborder operations.

Facilities at Dorval International Airport in Montreal and all other Canadian airports are capable of accommodating new or increased service.

J. Discuss **significant** service and equipment **changes** anticipated by the applicants and the integration of American's domestic route system with Canadian's international route system:

At the present time, neither of the Joint Applicants anticipates significant changes in service patterns or equipment.

K. Describe any effect of granting the application on American's Civil Reserve Air Fleet (CRAF) commitments:

The American/Canadian Commercial Alliance Agreement will have no impact on American's CRAF commitments.

L. Discuss any labor issues that may result from the transaction, and whether, how and to what extent employees of the applicant airlines will be integrated. In particular, state whether the transaction or this **type of transaction was the subject** of recent collective bargaining between American and any of its unions and the nature of such discussions. Discuss whether American's unionized employees adversely affected by the agreement would be compensated or protected by a collective bargaining agreement and whether adversely affect-


ed non-unionized employees would be compensated pursuant to separate arrangements:

The transaction raises no significant labor issues. There will be no integration of employees resulting from the application. American and Canadian remain independent, with neither having the ability to control the other. Unionized employees at both companies will continue to be represented by their respective unions. Although the American/Canadian **code-sharing** arrangements have been the subject of recent discussions between American and the Allied Pilots Association, the company and the **APA** have reached tentative agreement on most of the substantive matters of concern to the union. American does not anticipate any adverse effect of the transaction upon its unionized employees. On the contrary, American believes that the long-term impact of the transaction will be positive for the advancement of existing employees and for new job creation.


CONCLUSION

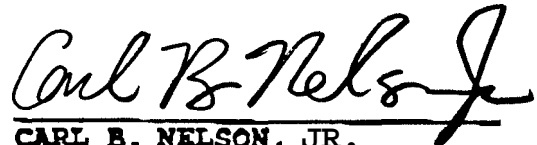
For the foregoing reasons, American and its regional affiliates and Canadian and its regional affiliates urge the Department to approve their Commercial Alliance Agreement under 49 USC 41309, and to grant discretionary antitrust immunity to the Commercial Alliance Agreement under 49 USC 41308.

Respectfully submitted,


KENNETH J. FREDEEN
solicitor
Canadian Airlines
International Ltd.

 *con*
GARY R. DOERNHOEFER
Senior Attorney
American Airlines, Inc.


STEPHEN P. SIBOLD
Acting General Counsel
Canadian Airlines
International Ltd.


CARL B. NELSON, JR.
Associate General Counsel
American Airlines, Inc.

November 3, 1995

**AMERICAN AIRLINES, INC. AND
CANADIAN AIRLINES INTERNATIONAL LTD.
JOINT APPLICATION FOR ANTITRUST IMMUNITY**

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COMMERCIAL ALLIANCE AGREEMENT

This Agreement dated _____ 1995, is made by and **between** American Airlines, Inc. ("American") and Canadian Airlines International Ltd., ("Canadian"). American is a Delaware corporation **with its principal office** at 4333 Amon Carter Boulevard, Fort Worth, Texas 76155. Canadian is an Alberta corporation with its principal office at **700 Second Street, S.W., Suite 2800, Calgary, Alberta T2P 2W2, Canada.**

RECITALS

Whereas AMR Corporation ("**AMR**", the **parent** to American) and Canadian have previously entered into a **Services** Agreement dated April 27, 1994 under which various divisions of **AMR** provide the following services to Canadian, and under the managerial control of Canadian pricing and yield management, operations planning, international base operations, food and beverage support, reservations, ground operations, capacity planning, technical (including **data** processing) and accounting services. **American** and Canadian (collectively the "**Parties**") have entered into a Canadian Plus Participating Agreement dated December 29, 1992, and an **AAdvantage** Participating Carrier Agreement dated December 29, 1992 in order to expand their respective frequent flyer programs. In order to offer improved customer service and enhance international competition the **Parties** have also entered into an agreement **pertaining** to reciprocal codesharing, which **codesharing** was approved by the National **Transportation** Agency of Canada on April 28, 1995, and by **the United States** Department of Transportation on May 18, 1995 and which resulted **in** the commencement of codesharing flights by the **Parties** on June 19, 1995 (the "Cooperative Service Agreement").

Whereas the Parties desire to strengthen their airline alliance through the implementation of specific cooperative programs which will generate efficiencies for each carrier, allow each carrier to **serve** routes that **would** not be feasible without this Agreement, and thereby **strengthen** each carrier as an independent competitor in the global air **transportation** marketplace.

Whereas the cooperative programs **contemplated** hereunder will create greater international competition by developing new service products and expanding the scope of operations through the efficiencies and synergies created by the optimized use of certain resources of the **Parties**.

Whereas each such cooperative program shall be implemented pursuant to a specific agreement to be negotiated between the Parties, which agreement shall set out the terms and conditions to apply to such cooperative **program**.

Whereas the governments of Canada and the United States of America have recently entered into an Air Transport Agreement dated February **24**, 1995 which, among other things, notes the desire of both countries to promote **transborder** commercial air

services to the fullest possible extent and as well their desire to make it possible for individual airlines to offer the **travelling** and shipping public a variety of service options at the lowest prices.

Whereas the Air Transport Agreement **specifically** contemplates that an airline of one country may enter into **cooperative** arrangements with an airline of the other **country**, subject to compliance with applicable laws and regulations.

Whereas the **Parties** intend that the implementation and operation of each cooperative program contemplated hereunder **shall** be in full conformity with the laws and regulatory requirements to which each carrier is subject, including without limitation those pertaining to national ownership and control.

Now therefore, in consideration of the premises and the mutual covenants and agreements contain herein, the Parties agree, subject to all necessary approvals from the requisite government authorities, to enter into this Agreement under the terms and conditions set forth herein.

Article 1: Scope of the Agreement

1.1 **Scope**

American and Canadian hereby each agree to enhance their commercial cooperation pursuant to the principles set forth herein, which will be implemented to achieve a **high** level of cooperation **between** the carriers' sales and marketing activities emphasizing their combined route networks, generate **efficiencies** for each carrier, and make each carrier a **stronger** independent competitor in the **global** air transportation marketplace.

1.2 **Objective**

The objective of this Agreement is to establish **a** legal framework under which American and Canadian may facilitate the expansion and enhancement of the current cooperative marketing efforts between American and Canadian as set forth in the Cooperative **Service** Agreement. Accordingly, this Agreement will:

- 1.2.1 be **taken** into account on matters concerning the interpretation, administration and exploitation of the Cooperative Service Agreement, and
- 1.2.2 set **forth** the principles governing the development of additional agreements, including agreements to further define and implement the **Passenger** Program and the Cargo Program, as defined in Article 2 hereof.

Article 2: Cooperation in Passenger and Cargo Programs

2.1 Cooperative Marketing Programs

American and Canadian hereby agree, as **part** of **their** cooperation on commercial operations, to market both carriers' air **transportation** of passengers through cooperative, joint marketing operations and programs (the "Passenger Program"). The Passenger Program will include those joint sales and marketing elements set forth in Section 2.2.

2.2 Passenger Program

Upon execution of this Agreement, American and Canadian will proceed to negotiate one or more **agreements** for a comprehensive global marketing and sales program of air transportation on American and Canadian. The Passenger Program may include the following:

2.2.1 General Policies

Policies, procedures, **information** systems, and programs **that** will facilitate the Passenger Program.

2.2.2 Service Standards

The creation of mechanisms to promulgate, administer and enforce **the** levels of quality and service standards and **to** ensure that the cooperative service products are viewed as seamless and transparent to the customers. In this regard, passengers booked and ticketed on **the** cooperative services of the Parties will receive the same service and amenities, both **on** the ground and in-flight, as each of **the Party's own online** passengers.

2.2.3 Operational Committees

The **establishment** of one or more operational **committees** to oversee joint project development, budgets, directions and other cooperative activities hereunder.

2.2.4 Service Contracts

The use of service contracts between the Parties and standard service **contracts** **with** third parties to avoid redundancy and to ensure that **the delivery** of services is consistent with the joint products and joint identities of the Parties.

2.2.5 Schedule Coordination

The coordination of schedules, third party marketing, network planning, and information systems to maximize sales possibilities by connecting services between **the** American and Canadian systems.

2.2.6 New Markets

The entry of either carrier into new markets, as regulatory requirements permit, in order to expand the combined presence of American and Canadian throughout transportation markets worldwide.

2.2.7 Passenger Pricing and Inventory **Strategy**

The pricing strategy and the **fares** to be charged and inventory management, including systems, by each air carrier with respect to all **Passenger** Program products, including wholesale net fares, corporate discount programs, and airline prorates.

2.2.8 sales **Personnel**

A combination of American and **Canadian** sales personnel, including a common staff, who would be **authorized** to represent **both American** and Canadian, independently and jointly, in marketing their products to customers and travel agents for sales of the services offered by both carriers. The joint marketing program may be structured as a joint venture of American and Canadian selling a seamless. online-quality joint product or set of products.

2.2.9 Commission Coordination

The establishment of a **unified** commission program, including agency. group, corporate and override commissions programs to be agreed upon from time to time **by** the **Parties** throughout **the** term hereof.

2.2.10 Travel Agent Contracts .

The development and use of standard form contracts for sales to travel agencies, general sales agents, corporations, organizations and individuals.

2.2.11 Advertising and Media **Programs**

The establishment of advertising and media programs that jointly promote American and Canadian as a seamless, worldwide transportation system, consistent with applicable regulations concerning the advertising of **codeshare** services.

2.2.12 Ancillary Programs

The establishment of ancillary programs, including, without limitation, travel packages, coordination of facilities, information systems, or mail service to enhance the products marketed by the **Parties**.

2.2.13 Frequent Flyer Program Coordination

The coordination of frequent flyer and similar programs, including elements thereof pertaining to mileage accrual and redemption rates, frequent flyer upgrades, and promotional programs.

2.2.14 Revenue Allocation

The establishment of agreements and procedures for the allocation of revenues on specific routes.

2.2.15 Partner Incentives

The establishment of incentives to ensure **that** each carrier is fully committed to **the** success of the cooperative service products.

2.2.16 Marketing and Accounting Information

The joint use of marketing and accounting data, and information **systems** available to the Parties, consistent with and subject to **all** applicable laws and agreements governing each **Party**.

2.2.17 Joint Identity

The development of a joint identity for their **codeshare** product(s) through jointly developed **service** logos, symbols or names, that would maintain the identity marks of the individual carriers consistent with the requirements of 14 CFR 399.82, **and** which will describe or identify the services, products, or programs of either or both carriers, whether or not previously registered as trademarks in the United States, Canada, or any other country.

2.2.18 Resolution of Dispute

The assignment of specific personnel from both carriers, at various **levels**, with authority to resolve disputes or waive conditions.

2.3 cargo Program

In addition to **the** Passenger Program, **the** cooperative marketing operations of **the** Parties shall include joint cargo sales and marketing (**the** "Cargo Program"). The **terms**

of the Cargo Program will include those elements on which the Parties mutually agree including, without limitation, elements **equivalent** to those set forth in Section 2.2 hereof and the marketing of both carriers' air transportation of **cargo** through cooperative, joint marketing and operations programs.

2.4 Fully Integrated Marketing Force

The **Parties** shall expand the Passenger Program and the Cargo Program so as to ultimately provide a fully integrated marketing **force** throughout the world to aggressively sell and market the products and services of American and Canadian both independently and jointly. Any expansion of these programs shall be subject to mutual written consent of American **and** Canadian.

2.5 Prior Consent of the **Parties** Required

All aspects of commercial cooperation hereunder shall be subject to the prior review and written approval of both American and Canadian. Each **Party** shall at all times retain **and** exercise its own managerial control and decision making **authority** in regards **to** any decision by it to engage in any aspect of the commercial cooperation referred to hereunder.

Article 3: Government and Regulatory Approvals

3.1 Government Compliance

In carrying out this agreement, the **parties** will comply with all necessary government laws, regulations, and requirements, including but not limited to the applicable competition laws.

3.2 Government Approvals

The Parties shall take all necessary steps, in cooperation with each other, to obtain all approvals, if any, from government authorities in the United States and Canada. or any other **appropriate** governmental **authority**, in order to carry out the terms of this Agreement.

3.3 Governmental Limitations

In the event that any governmental agency or **regulatory** body having jurisdiction over the subject matter hereof shall require **any material** condition or limitation to this Agreement, the **Parties** hereto shall negotiate in good **faith** to make such amendments to this Agreement as **shall** be necessary to achieve the purposes and objectives of this Agreement. If any such condition or limitation, in the reasonable judgment of either Party, is fundamental to the intent **of** such **Party** and the operation of this Agreement, **the** Party shall have the right to declare that this Agreement shall not **enter** into effect or to terminate this Agreement upon written notice.

3.4 Governmental Regulations

In ~~the~~ event that any necessary governmental approval is withdrawn ~~or~~ any governmental order issued or there is any change in applicable ~~statutes~~, laws, or regulations government the operations contemplated by this Agreement which would materially affect the rights, benefits, and/or obligations of the **Parties** hereto, the **Patties** shall, within ninety (90) days thereafter, comply therewith by mutual agreement. and shall not be liable to each other for failure to **fulfil** any obligations **under** this Agreement that may be consistent with such changes, orders, statutes, laws, or regulations or this Agreement shall be deemed to be terminated. The **Parties** shall **negotiate** in good faith to **make** amendments to this Agreement as may be necessary and sufficient to comply with governmental regulations, and to achieve the purposes and objectives of **this** Agreement.

Article 4: **Execution** and Termination

4.1 Duration of Agreement

This Agreement shall be effective for **an** initial term of one (1) year, and remain in effect thereafter until terminated by either **Party** upon not less than one-hundred and eighty (180) days prior **written** notice to the other **Party**. The **Parties** agree that this Agreement may be executed in counterparts, including **facsimile** transmission copies, that each executed copy shall **be** deemed to be an original, and that all originals together shall constitute one instrument.

4.2 Termination for Cause

Notwithstanding the provision of Article 4, paragraph 1, either **Party** may terminate this Agreement at any time if the other **Party** defaults in observing or performing any of the provisions of this Agreement, becomes insolvent, makes a general assignment for the benefit of creditors, or **commits** an act of bankruptcy, or if a petition in bankruptcy for its reorganization or the readjustments of its indebtedness be filed by or against it. or if a receiver, trustee, or liquidator of all or substantially all of its **property** be appointed or applied for if it ceases to **be** in business as an air carrier.

4.3 Obligations

Each **Party** agrees to fulfil all obligations which accrued hereunder prior to the termination becoming effective.

4.4 Notification

Notice of termination shall be addressed to the principal office of either Party, mentioned in the preamble of **this** Agreement, to the attention of the Corporate Secretary.

Article 5: Claims and Indemnification

5 . Terms

American and Canadian shall each defend, indemnify, and hold harmless the other **Party**, its officers, directors, **affiliates**, employees, agents, and contractors from and against any and all claims, causes of action, lawsuits and damages of any kind whatsoever (including reasonable attorneys fees, and cost of litigation) arising from or in connection with each Party's responsibilities, obligations, and performance under this Agreement or the acts or omissions of either **Party**, its officers, employees or agents which are in any way related to services contemplated by this Agreement.

5.2 Wilful Misconduct

Notwithstanding the provisions of **Article 5**, paragraph 1, **a Party** hereto shall not be obliged to indemnify and save **free** and harmless the other **Party** to the extent that it can prove that the claims, causes of action, **lawsuits** or damages resulted from the wilful misconduct of the other **Party**.

5.3 Notification

In the event that any claim is made or any suit is commenced against the **Party** entitled to be **indemnified** in accordance with this **Article 5**, such **Party** shall give prompt **written** notice to the other **Party**, whereupon the latter **Party** shall **undertake**, at its own cost and expense, the defense of such suit or settlement of such claims and pay **the** amount of any final judgment or decree or of **any** settlement negotiated by the indemnifying **Party** and all expenses incident thereto. **The Party** to be indemnified shall cooperate by furnishing promptly to the other **Party** at its request all pertinent data, **papers**, records, and information which it has at its disposal.

Article 6: Force Majeure

6 . Terms

Except for any payments due hereunder, either **Party** shall be relieved of its obligations hereunder in the event and to the extent that performance thereof is delayed or prevented by any cause reasonably beyond its control, including, but not limited to, acts of God, public enemies, war, civil disorder, **fire**, flood, inclement weather, explosion, **labour** disputes or strikes (including those by its own employees), or any acts or orders of any governmental authority, including the United States, Canada, countries of codeshared points, and any third country. Notwithstanding the foregoing provision, during the course of the **non-performing** Party's failure to perform, **the** other **Party** may elect to take, after given seven (7) days' advance written notice to the non-performing **Party**, one or more of the following actions:

6.1.1. Temporary Suspension of Agreement

The performing Party may suspend the operation of this Agreement and such other Party's covenants and obligations hereunder;

6.1.2 Terminate Agreement

The performing Party may terminate this **Agreement** if the non-performing Party's non-performance has continued for a period of **thirty** (30) days or more; or

6.1.3. Continue Agreement

The performing **Party** may continue to perform the terms **of** this Agreement, or portions thereof, under such further terms and conditions as the Parties are able to reach through written agreement.

Article 7: Applicable Law and Arbitration

7.1 Applicable Law and Arbitration

This Agreement **shall** be governed by and interpreted pursuant to the substantive laws **of the State** of New York. All disputes arising in connection with this Agreement shall be resolved pursuant to the **procedures** set forth in Section 7, Mediation and **Arbitration**, of the Services Agreement.

Article 8: Headings

8.1 Convenience **Purposes**

The headings contained in this Agreement are inserted as a matter of convenience only and are not intended in any way to define, limit, or be used in connection with the interpretation **of** this Agreement.

Article 9: Assignment

9.1 Terms

Neither **Party** may assign any rights or obligations under this Agreement without the prior written consent of **the** other Party. Any attempted assignment, **without** such prior consent of the other **Party**, shall be null and void and of no effect.

Article 10: Severability

10.1 Non-material Provision

If any non-material provision contained **in** this Agreement shall be held to be invalid or unenforceable in any respect in any jurisdiction, such **invalidity** or unenforceability shall not affect the other provisions hereof which can be given effect without the **invalid** provision, and to this end the provisions of this Agreement are intended to be and shall be deemed severable.

10.2 Revised Provision

The Parties agree to use their best efforts to replace such invalid or unenforceable provision with a **valid and** enforceable provision having to the maximum extent possible the same economic or practical effect.

10.3 Material Provision

If in the reasonable judgement of either **Party**, any provision or provisions held to be invalid and unenforceable is or are fundamental to the intent of such Party and the operation of this Agreement, such **Party shall** have the right to terminate this Agreement upon not less than a ninety **(90)** day prior written notice to the other **Party**.

Article 11: Non-Waiver

11.1 Terms

No waiver of any provisions hereof shall **be** effective unless in writing and signed by both American and Canadian. Any single waiver shall not operate to waive subsequent or other defaults.

Article 12: Modification

12.1 Terms

Any additions to *or* modifications of this Agreement shall have to be agreed upon in writing by both **Parties**; provided, however, that any modifications or additions which become necessary by reason of **IATA** resolutions binding upon either or both of **the** Parties to this Agreement shall be deemed to be incorporated herein as from the effective date of such resolution.

Article 13: Filing Fees

13.1 Responsible Party

All filing fees in connection with this Agreement which may be prescribed under the national law of either Party to this Agreement, are payable by that Party.


Article 14: Construction of Agreement

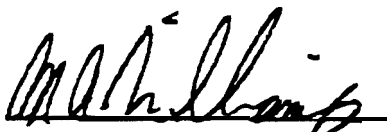
14.1 Interpretation of Terms

It is intended that the terms of this Agreement be interpreted and the cooperation related to products and services described herein be undertaken in a manner that would not would not cause the Parties to be mated for any purpose as participating in a partnership or joint venture.

Understood, and agreed

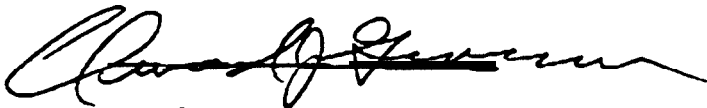
Canadian Airlines International Ltd.

By: 
Name: DON CASEY
Vice-President
Title: Capacity Planning
Date: November 2, 1995

By: 
Name: Mark A. Williams
Vice-President & Controller
Title: _____
Date: November 2, 1995

Understood, and agreed.

American Airlines, Inc.

By: 
Name: Arnold J. Grossman
title: Vice President International Affairs
Date: _____

Summary of U.S. - Canada Transborder Flight Frequencies

Rank	Operating Carrier	Weekly Roundtrip Frequencies	Frequency Share
1	Air Canada	755	24.8%
2	American	261	8.6%
3	Business Express ^{1/}	209	6.9%
3	Northwest	209	6.9%
5	Delta	196	6.4%
6	United	173	5.7%
7	Canadian	165	5.4%
8	USAir	150	4.9%
8	Horizon ^{1/}	150	4.9%
10	Air Ontario ¹¹	138	4.5%
11	USAir Express ^{1/}	121	4.0%
12	Air BC ^{1/}	79	2.6%
13	Comair ^{1/}	74	2.4%
14	flagship Airlines ^{2/}	70	2.3%
15	Mesaba ^{1/}	60	2.0%
16	Air Alliance ^{1/}	31	1.0%
17	Air Nova ^{1/}	29	1.0%
18	Kenmore Air Harbour	21	0.7%
19	Ontario Express ^{3/}	20	0.7%
19	Time Air ^{3/}	20	0.7%
21	Air Atlantic ^{3/}	19	0.6%
22	America West	14	0.5%
22	Continental	14	0.5%
22	Reno Air	14	0.5%
25	Midwest Express	12	0.4%
26	Skyway Airlines ^{1/}	11	0.4%
27	British Airways	7	0.2%
28	Air North	6	0.2%
29	Athabaska Airways	4	0.1%
29	Columbia Pacific	4	0.1%
31	Royal Air Maroc	3	0.1%
32	Taquan Air Service	1	0.0%
Total		3,040	100.0%

^{1/} Regional airline partner of non-alliance carrier(s).

^{2/} Regional airline partner of American.

^{3/} Regional airline partner of Canadian.

**Growth Following the New Air Transport Agreement
Between the United States and Canada
Compared with Growth Following
the Open Skies Agreement with The Netherlands**

United States • Netherlands
Weekly Scheduled Roundtrip Frequencies 11

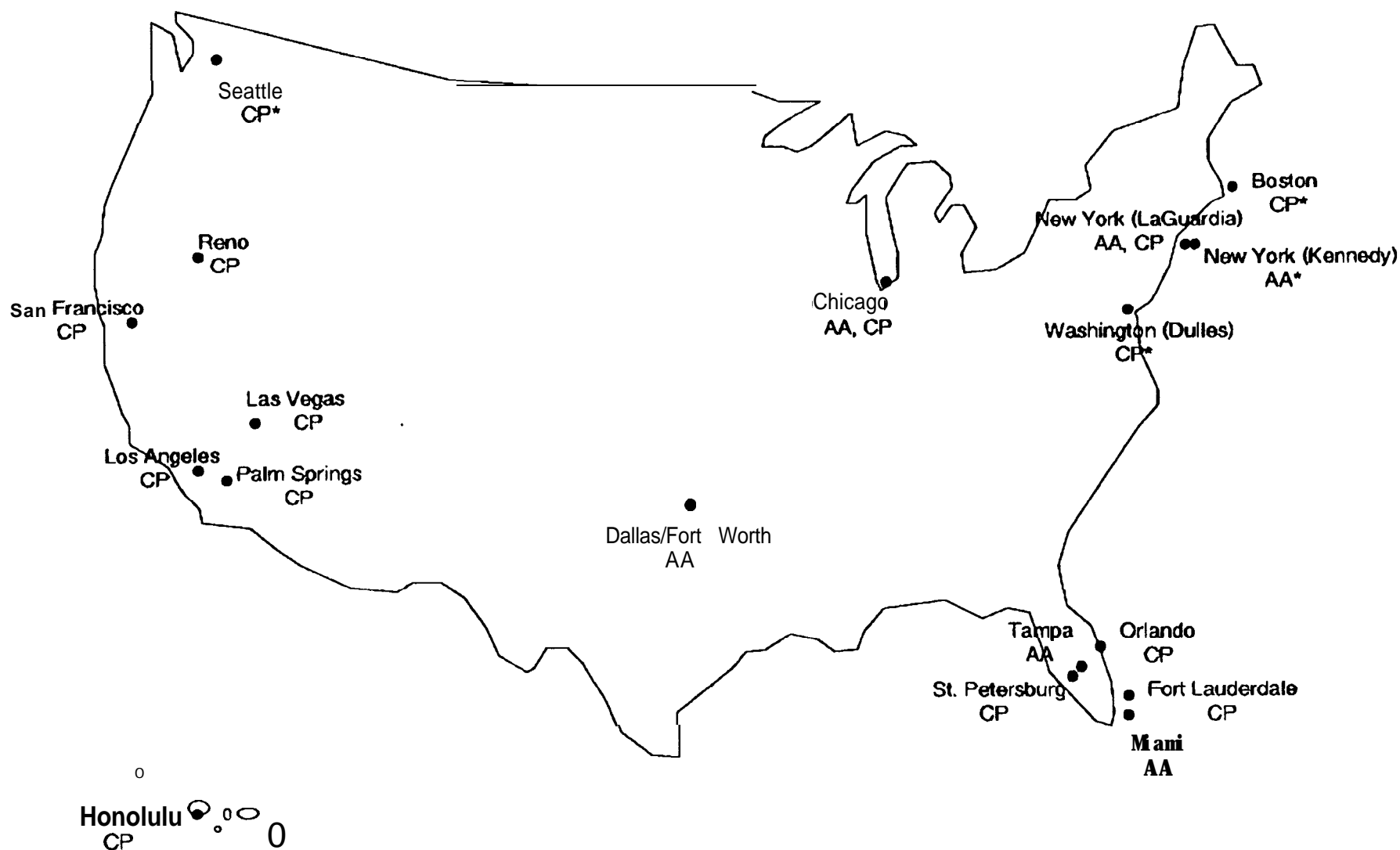
Market	January 1993	January 1994	Change
Total U.S. • Netherlands	90	111	23.3%

United States • Canada
Weekly Scheduled Roundtrip Frequencies 1/

Market	February 1995	November 1995	Change
Total U.S. • Canada	1,904	3,040	59.7%

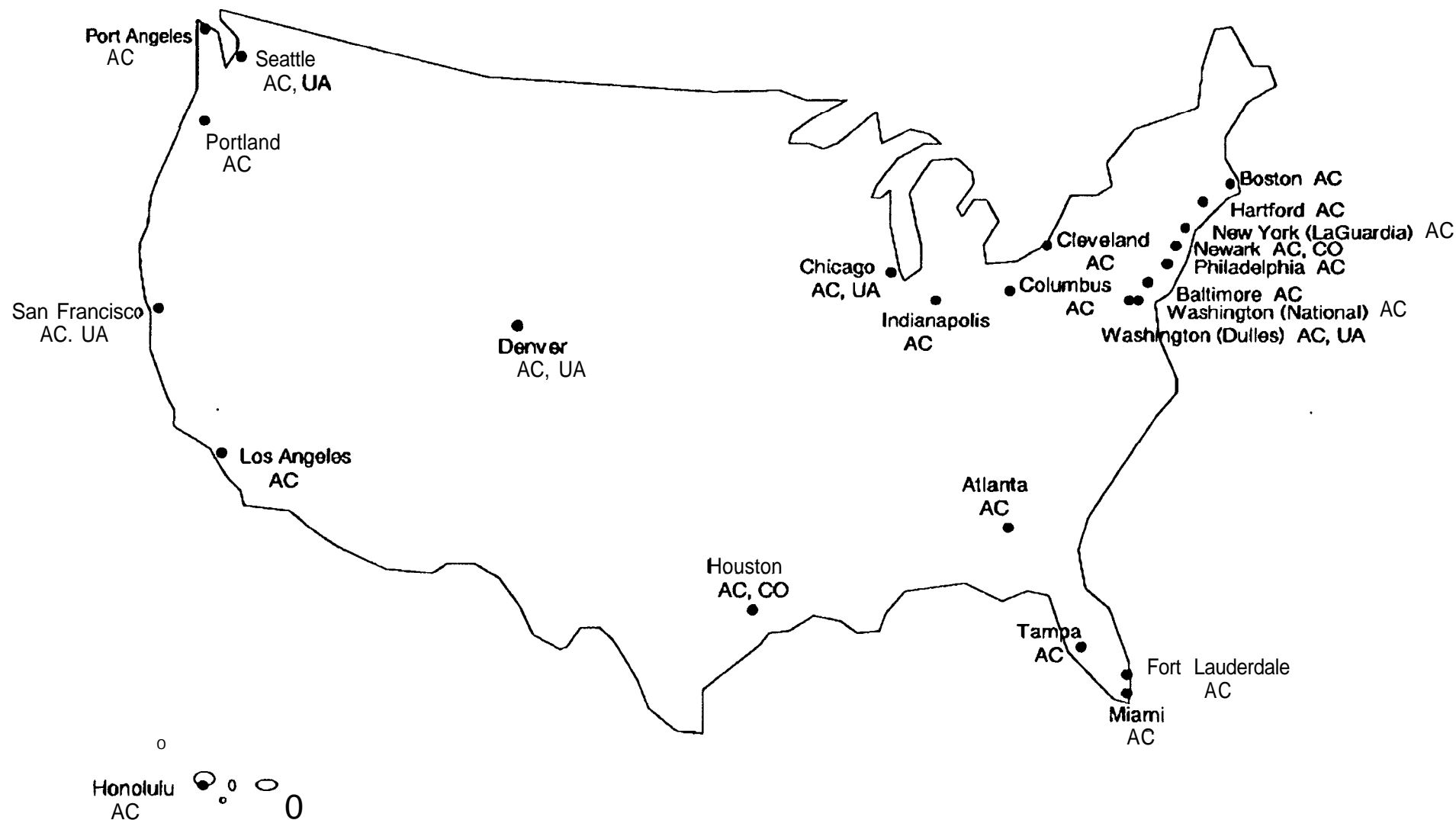
1 / Operating carriers only.

Nonstop Transborder U.S. Gateways: American and Canadian



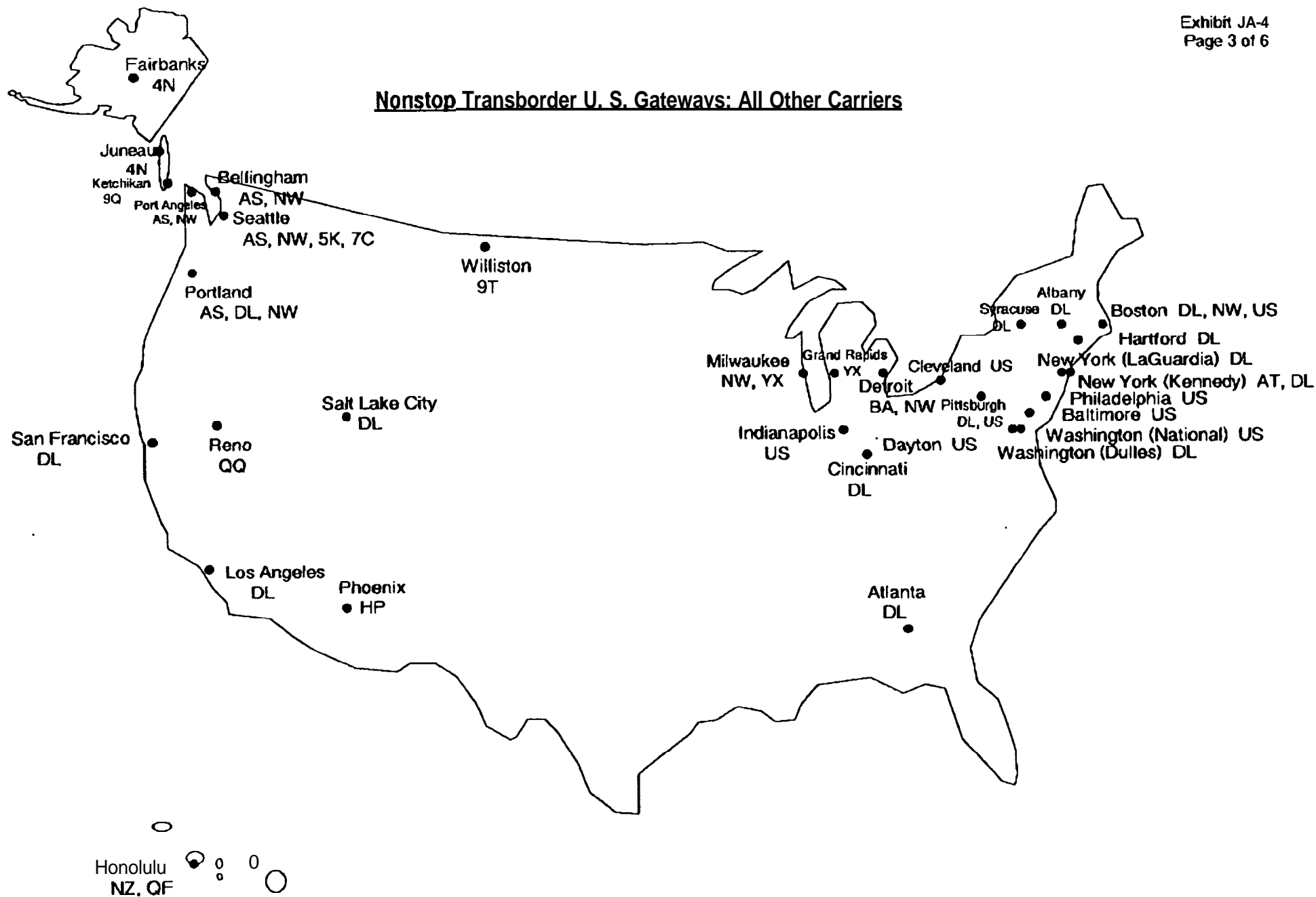
Source: Published airline schedules,
effective November 10, 1995.

Nonstop Transborder U. S. Gateways:
Air Canada. Continental. United



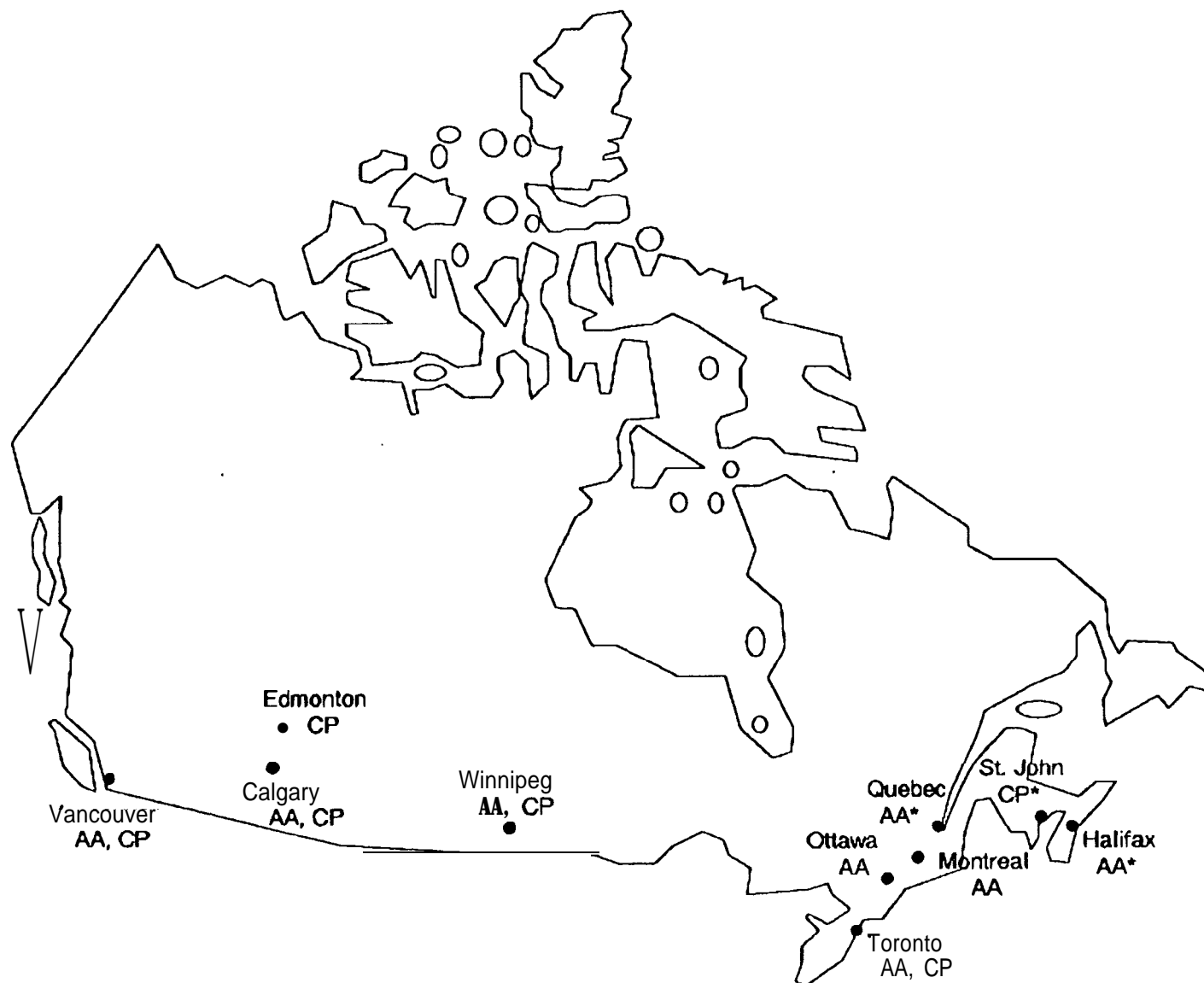
Source: Published airline schedules,
effective November 10, 1995.

Nonstop Transborder U. S. Gateways: All Other Carriers



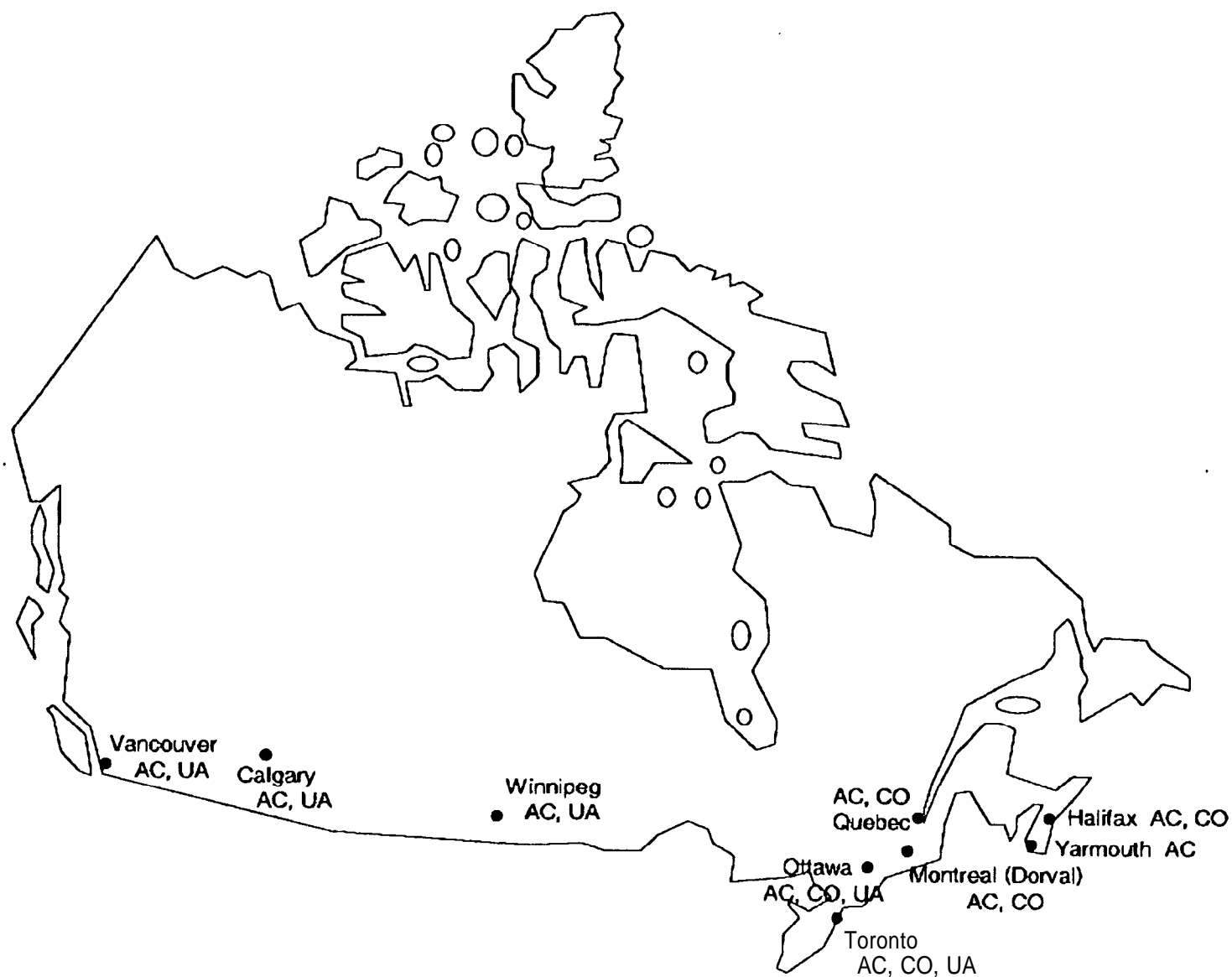
Source: Published airline schedules,
effective November 10, 1995.

Nonstop Transborder Canadian Gateways: American and Canadian



Source: Published airline schedules,
effective November 10, 1995.

Nonstop Transborder Canadian Gateways:
Air Canada. Continental. United



Source: Published airline schedules,
effective November 10, 1995.

**Nonstop Transborder Canadian Gateways:
All Other Carriers**



Source: Published airline schedules,
effective November 10, 1995.

U.S. - Canada Transborder Market Concentration Before and After Alliance

Rank	Operating Carrier	Frequency Share Before	HHI Score Before	Frequency Share After	HHI Score After
1	Air Canada	24.64%	616.80	24.84%	616.80
2	American	8.59%	73.71	0.00% 1/	0.00 1/
3	Business Express 2/	6.88%	47.27	6.88%	47.27
3	Northwest	6.88%	47.27	6.86%	47.27
5	Delta	6.45%	41.57	6.45%	41.57
6	United	5.69%	32.39	5.69%	32.39
7	Canadian	5.43%	29.46	14.01% 3/	196.37 3/
8	USAir	4.93%	24.35	4.93%	24.35
8	Horizon 2/	4.93%	24.35	4.93%	24.35
10	Air Ontario 2/	4.54%	20.61	4.54%	20.61
11	USAir Express 2/	3.98%	15.84	3.98%	15.84
12	Air BC 2/	2.60%	6.75	2.60%	6.75
13	Comair 2/	2.43%	5.93	2.43%	5.93
14	flagship Airlines 4/	2.30%	5.30	2.30%	5.30
15	Mesaba 2/	1.97%	3.90	1.97%	3.90
16	Air Alliance 2/	1.02%	1.04	1.02%	1.04
17	Air Nova 2/	0.95%	0.91	0.95%	0.91
18	Kenmore Air Harbour	0.69%	0.48	0.69%	0.48
19	Ontario Express 5/	0.66%	0.43	0.66%	0.43
19	Time Air 5/	0.66%	0.43	0.66%	0.43
21	Air Atlantic 5/	0.63%	0.39	0.63%	0.39
22	America West	0.46%	0.21	0.46%	0.21
22	Continental	0.46%	0.21	0.46%	0.21
22	Reno Air	0.46%	0.21	0.46%	0.21
25	Midwest Express	0.39%	0.16	0.39%	0.16
26	Skyway Airlines 2/	0.36%	0.13	0.36%	0.13
27	British Airways	0.23%	0.05	0.23%	0.05
28	Air North	0.20%	0.04	0.20%	0.04
29	Athabaska Airways	0.13%	0.02	0.13%	0.02
29	Columbia Pacific	0.13%	0.02	0.13%	0.02
31	Royal Air Maroc	0.10%	0.01	0.10%	0.01
32	Taquan Air Service	0.03%	0.00	0.03%	0.00
Total		100%	1,000	100%	1,093

Change In HHI Score

+93 +9.3%

1/ American and Canadian combined below.

2/ Regional airline partner of non-alliance carrier(s).

3/ American and Canadian combined.

4/ Regional airline partner of American.

5/ Regional airline partner of Canadian.

**Competitive Services in American/Canadian
Nonstop Transborder Markets
With Less than 50% Circuity**

1st Leg Dep			2nd Leg Dep		Arr Time	Elapsed Time	Elapsed vs.	Elapsed Best
Car	Flt	Airport	Connect City	Car	Flt	Time	Time	vs.
<i>Chicago-Calgary</i>								
A	A	1105	ORD			1144A 226P	3:42	+2%
CP	6277	ORD				1144A 226P	3:42	+2%
AA	1617	ORD				620P 906P	3:46	+4%
CP*	6279	ORD				620P 906P	3:46	+4%
AC	635	ORD				855A 1132A	3:37	0%
UA*	3011	ORD				855A 1132A	3:37	0%
AC	831	ORD				950A 147P	4:57	+37%
UA*	3007	ORD	Winnipeg	AC 831		950A 147P	4:57	+37%
NW	563	ORD	Minneapolis/St Paul	NW	1543	900A 106P	5:06	+41%
<i>Chicago-Montreal</i>								
AA	1734	ORD				715A 1006A	1:51	0%
CP*	6281	ORD				715A 1006A	1:51	0%
AA	266	ORD				1020A 115P	1:55	+4%
CP*	6283	ORD				1020A 115P	1:55	+4%
AA	764	ORD				130P 426P	1:56	+5%
CP*	6285	ORD				130P 426P	1:56	+5%
AA	1634	ORD				450P 748P	1:58	+6%
CP*	6287	ORD				450P 748P	1:58	+6%
AA	1520	ORD				820P 1118P	1:58	+6%
C P	6289	ORD				820P 1118P	1:58	+6%
AC	784	ORD				1110A 202P	1:52	+1%
AC	766	ORD				510P 802P	1:52	+1%
AC	788	ORD				755P 1104P	2:09	+16%
<i>Chicago-Ottawa</i>								
AA	1276	ORD				705A 950A	1:45	+8%
CP*	6191	ORD				705A 950A	1:45	+8%
CP*	6193	ORD				135P 423P	1:48	+11%
AA	1828	ORD				139P 427P	1:48	+11%
AA	2044	ORD				815P 1104P	1:49	+12%
CP*	6195	ORD				815P 1104P	1:49	+12%
AC	312	ORD				1010A 1247P	1:37	+0%
UA*	3002	ORD				1010A 1247P	1:37	+0%
AC	316	ORD				610P 847P	1:37	0%
UA*	3004	ORD				610P 847P	1:37	0%

**Competitive Services in American/Canadian
Nonstop Transborder Markets
With Less than 50% Circuity**

1st Leg Dep			Connect City	2nd Leg Dep			Arr Time	Elapsed Time	Elapsed vs. Best
Car	Fit	Airport		Car	Fit	Time			
Chicago-Toronto									
CP	546	ORD				1220P 240P		1:20	+4%
AA	632	ORD				655A 918A		1:23	+8%
CP*	6221	ORD				655A 918A		1:23	+8%
AA	1850	ORD				945P 1208A		1:23	+8%
AA	1214	ORD				1020A 1244P		1:24	+9%
C P	6223	ORD				1020A 1244P		1:24	+9%
A A 4 6 0		ORD				125P 350P		1:25	+10%
CP*	6225	ORD				125P 350P		1:25	+10%
AA*	6548	ORD				700P 925P		1:25	+10%
CP	548	ORD				700P 925P		1:25	+10%
AA	1956	ORD				435P 703P		1:28	+14%
CP*	6227	ORD				435P 703P		1:28	+14%
AA	1594	ORD				830P 1059P		1:29	+16%
CP*	6231	ORD				830P 1059P		1:29	+16%
AC	812	ORD				810A 1027A		1:17	0%
AC	816	ORD				300P 520P		1:20	+4%
AC	818	ORD				550P 810P		1:20	+4%
AC	814	ORD				125P 347P		1:22	+6%
UA	1478	ORD				1055A 117P		1:22	+6%
AC	820	ORD				705P 927P		1:22	+6%
UA	252	ORD				845P 1110P		1:25	+10%
UA	402	ORD				750A 1017A		1:27	+13%
UA	1214	ORD				150P 417P		1:27	+13%
UA	524	ORD				530P 759P		1:29	+16%
Chicago-Winnipeg									
AA	1857	ORD				244P 450P		2:06	+6%
CP*	6183	ORD				244P 450P		2:06	+6%
AA	1627	ORD				914A 1123A		2:09	+8%
CP*	6181	ORD				914A 1123A		2:09	+8%
AA	1635	ORD				845P 1100P		2:15	+13%
CP*	6165	ORD				845P 1100P		2:15	+13%
AC	831	ORD				950A 1149A		1:59	0%
UA*	3007	ORD				950A 1149A		1:59	0%
A C	833	ORD				835P 1034P		1:59	+0%
UA*	3009	ORD				835P 1034P		1:59	+0%

**Competitive Services in American/Canadian
Nonstop Transborder Markets
With Less than 50% Circuity**

1st Leg Dep			2nd Leg Dep			Arr	Elapsed	Elapsed
Car	Flt	Airport	Connect City	Car	Flt	Time	Time	Time vs. Best
<i>Dallas/Ft. Worth-Calgary</i>								
AA	1439	DFW				1059A 144P	3:45	0%
CP*	6261	DFW				1059A 144P	3:45	0%
AA	1331	DFW				358P 647P	3:49	+2%
CP*	6263	DFW				358P 647P	3:49	+2%
AA	895	DFW				640P 931P	3:51	+3%
CP*	6265	DFW				640P 931P	3:51	+3%
UA	387	DFW	Denver	AC	588	700A 1042A	4:42	+25%
UA	725	DFW	Denver	UA	1466	623P 1009P	4:46	+27%
UA	726	DFW	Denver	AC	5009	623P 1009P	4:46	+27%
UA	1465	DFW	Denver	UA	1460	957A 204P	5:07	+36%
DL	383	DFW	salt Lake city	DL	641	711P 1129P	5:18	+41%
CO	550	DFW	Houston	AC	767	1130A 402P	5:32	+48%
CO	550	DFW	Houston	CO*	8167	1130A 402P	5:32	+48%
<i>Dallas/Ft. Worth-Toronto</i>								
AA	490	DFW				801A 1154A	2:53	0%
CP*	6251	DFW				801A 1154A	2:53	0%
AA	488	DFW				1251P 444P	2:53	+0%
CP*	6253	DFW				1251P 444P	2:53	+0%
AA	458	DFW				517P 914P	2:57	+2%
CP*	6255	DFW				517P 914P	2:57	+2%
US	1860	DFW	Pittsburgh	US	152	1150A 459P	4:09	+44%
UA	576	DFW	Chicago	UA	1478	807A 117P	4:10	+45%
DL	1243	DFW	Cincinnati	DL*	3719	510P 1025P	4:15	+47%
<i>Dallas/Ft. Worth- Vancouver</i>								
AA	1507	DFW				935A 1204P	4:29	0%
CP*	6297	DFW				935A 1204P	4:29	0%
AA	1437	DFW				649P 921P	4:32	+1%
CP*	6299	DFW				649P 921P	4:32	+1%
DL	1729	DFW	Portland	DL	209	1012A 145P	5:33	+24%
DL	179	DFW	Seattle	AC'	1556	342P 810P	6:28	+44%
HP	808	DFW	Phoenix	HP	815	520P 950P	6:30	+45%
DL	885	DFW	Seattle	AC	1552	1151A 430P	6:39	+48%

**Competitive Services in American/Canadian
Nonstop Transborder Markets
With Less than 50% Circuity**

1st Leg Dep				Connect City	2nd Leg Dep		Arr Time	Elapsed Time	Elapsed vs. Best
Car	Flt	Airport	Car		Flt Time				
Miami-Montreal									
AA	470	MIA			705P	1038P	3:33	+8%	
CP*	6249	MIA			705P	1038P	3:33	+8%	
AC	933	MIA				110P	427P	3:17	0%
WV	210	MIA	Tampa	AC 925	1125A	402P	4:37	+41%	
DL*	3550	MIA	Orlando	AC 923	1040A	322P	4:42	+43%	
us	1040	MIA	Philadelphia	us 164	1240P	530P	4:50	+47%	
3M	493	MIA	Orlando	AC 923	1030A	322P	4:52	+48%	
UA	996	MIA	New York (LaGuardia)	DL 504	715A	1208P	4:53	+49%	
Miami-Toronto									
AA	450	MIA			745A	1049A	3:04	+4%	
CP	6241	MIA			745A	1049A	3:04	+4%	
AA	694	MIA			700P	1012P	3:12	+8%	
CP	6243	MIA			700P	1012P	3:12	+8%	
AA	1130	MIA			135P	559P	4:24	+49%	
AC	911	MIA			730A	1027A	2:57	0%	
AC	915	MIA			1105A	202P	2:57	+0%	
AC	913	MIA			1255P	352P	2:57	+0%	
AC	919	MIA			700P	957P	2:57	+0%	
New York-Toronto									
AA	1034	LGA			1123A	1246P	1:23	+8%	
CP	6205	LGA			1123A	1246P	1:23	+8%	
AA	1154	LGA			830P	954P	1:24	+9%	
CP*	6213	LGA			830P	954P	1:24	+9%	
AA*	6627	LGA			425P	550P	1:25	+10%	
CP	527	LGA			425P	550P	1:25	+10%	
AA*	6521	LGA			730A	855A	1:25	+10%	
CP	521	LGA			730A	855A	1:25	+10%	
AA*	6523	LGA			945A	1110A	1:25	+10%	
CP	523	LGA			945A	1110A	1:25	+10%	
AA	2071	LGA			655A	820A	1:25	+10%	
CP*	6201	LGA			655A	820A	1:25	+10%	
AA	1204	LGA			1249P	216P	1:27	+13%	
CP	6219	LGA			1249P	216P	1:27	+13%	
AA	261	LGA			830A	958A	1:28	+14%	
CP*	6203	LGA			830A	958A	1:28	+14%	

**Competitive Services in American/Canadian
Nonstop Transborder Markets
With Less than 50% Circuity**

1st Leg		Dep	Connect City	2nd Leg		Dep	Arr	Elapsed	Elapsed
Car	Flt	Airport		Car	Flt	Time	Time	Time	vs. Best
AA	253	LGA				345P	514P	1:29	+16%
CP*	6209	LGA				345P	514P	1:29	+16%
AA	1244	LGA				546P	715P	1:29	+16%
CP*	6471	LGA				546P	715P	1:29	+16%
CP*	6211	LGA				546P	715P	1:29	+16%
AA*	6525	LGA				1210P	140P	1:30	+17%
CP	525	LGA				1210P	140P	1:30	+17%
AA*	6531	LGA				700P	830P	1:30	+17%
CP	531	LGA				700P	830P	1:30	+17%
AC	709	LGA				1115A	1232P	1:17	0%
AC	705	LGA				915A	1034A	1:19	+3%
AC	707	LGA				1015A	1134A	1:19	+3%
AC	721	LGA				515P	634P	1:19	+3%
AC	727	LGA				815P	934P	1:19	+3%
AC	713	LGA				115P	235P	1:20	+4%
AC	717	LGA				315P	435P	1:20	+4%
AC	723	LGA				615P	737P	1:22	+6%
AC	725	LGA				715P	837P	1:22	+6%
AC	701	LGA				715A	841A	1:26	+12%
AC	703	LGA				815A	941A	1:26	+12%
AC	719	LGA				415P	541P	1:26	+12%
AC	731	EWR				735A	902A	1:27	+13%
AC	733	EWR				1035A	1202P	1:27	+13%
AC	735	EWR				1245P	212P	1:27	+13%
AC	737	EWR				330P	457P	1:27	+13%
AC	739	EWR				505P	632P	1:27	+13%
AC	729	EWR				700P	827P	1:27	+13%
<i>Tampa-Toronto</i>									
AA	1130	TPA				315P	559P	2:44	+8%
CP	291	PIE				100P	345P	2:45	+9%
AC	901	TPA				1125A	157P	2:32	0%
AC	905	TPA				820P	1052P	2:32	0%

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing joint application by first-class mail on all persons named on the attached service list.


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